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THE FEDERAL FINANCING BANK AND THE DEBT CEILING

HEARING

BEFORE THE

SUBCOMMITTEE ON ECONOMIC STABILIZATION

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

FIRST SESSION

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THE FEDERAL FINANCING BANK AND THE DEBT CEILING

THURSDAY, OCTOBER 31, 1985

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ECONOMIC STABILIZATION,
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Washington, DC.

The subcommittee met, pursuant to call, at 9:30 a.m., in room 2128, Rayburn House Office Building, Hon. John J. LaFalce (chairman of the subcommittee) presiding.

Present: Chairman LaFalce, Representatives Oakar, Cooper, Kaptur, Levin, Torres, Shumway, and Wortley.

Chairman LAFALCE. The Subcommittee on Economic Stabilization will come to order.

Three weeks ago, the Treasury used a little known and little understood institution, the Federal Financing Bank, to avoid a default by the Federal Government. Today, the Federal Government is once again on the brink of default. Unless something is done, the Treasury is likely to bump up against the debt ceiling tomorrow.

The purpose of today's hearing is to inquire into how the Treasury used the Federal Financing Bank to avert default on October 9, whether it plans to use the FFB again for that purpose, and whether, indeed, this is a legal and appropriate use of the FFB. In addition, this hearing will ask the Treasury to explain its latest proposal to avert default—the disinvestment of securities held by the Social Security Trust Fund.

The Federal Financing Bank was created by Congress in 1973 to be the Federal Government's central financing authority for marketable securities issued or guaranteed by Federal agencies. During the late 1960's and early 1970's, there had been a dramatic increase in the number of such securities offered in the Government securities market, which strained the capacity of the market and pushed up financing costs.

Rather than have each Federal agency sell the securities it issued or guaranteed on the market, the FFB was created to centralize and streamline the process, and lower financing costs.

The legislation creating the FFB placed it off-budget. In addition, and perhaps most critically for the purposes of this hearing, the legislation authorized the FFB to borrow up to $15 billion directly from the market to finance its operations.

Although the FFB is located in the Treasury Department, it is legally a separate corporate instrumentality of the Federal Government. The debt it issues is therefore not considered Treasury debt,

and is thus not subject to the statutory public debt limit. This issue, I know, will be addressed by our witnesses this morning.

Since debt issued by the FFB is not subject to the debt limit, the Treasury was able to tap this unrestricted source of borrowing to keep the Federal Government running. We hope to learn from our witnesses this morning precisely the transactions made through the FFB to extend the debt limit, the legality of these transactions, and whether the FFB will and should be used again for this purpose.

It is my understanding that all of the FFB borrowing authority has not yet been utilized by the Treasury. Yet the Treasury is apparently planning to disinvest some securities held by the Social Security Trust Fund to extend the debt limit.

We would like a clear explanation from the Treasury of whether it plans to use all of the FFB borrowing authority before it resorts to the use of the Social Security Trust Fund, if not, then why not, and what, if any, risks are posed to the trust fund by the disinvestment procedure. In addition, we would like to know how long the FFB borrowing authority by itself could carry the Federal Government. We would also like to know how long we could use the disinvestment procedure before running into debt limit difficulties.

Our witnesses this morning are: John Niehenke, Acting Assistant Treasury Secretary for Domestic Finance; Edward P. Snyder, vice president, National Bank of Detroit, former Treasury Department Senior Adviser for Debt Research; and Harry S. Havens, Assistant Comptroller General.

Our first witness will be the representative of the Treasury Department, Mr. Niehenke.

STATEMENT OF JOHN J. NIEHENKE, ACTING ASSISTANT SECRETARY FOR DOMESTIC FINANCE, DEPARTMENT OF THE TREASURY

Mr. NIEHENKE. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, it is a pleasure to be here this morning to discuss the use of the Federal Financing Bank to keep the Federal Government within the statutory ceiling on the public debt.

You have asked for a discussion of the transactions which were made to stay within the debt limit, the reasons for using the FFB, the other alternatives that were considered, and the consequences of a possible default.

I would like to begin by briefly describing the statutory framework governing the borrowing operations of the Federal Government, including the borrowing activities of the FFB.

Treasury securities are issued under the authority of the public debt statutes, chapter 31 of title 31, United States Code. Treasury issues these securities to finance both budget and off-budget deficits, including the borrowing needs of the FFB, and to refund maturing debt. Treasury also issues securities to the various government investment accounts and trust funds. The act places a ceiling on the amount of outstanding obligations issued under the act, certain obligations fully guaranteed as to principal and interest by the United States, largely debentures issued by the Federal Housing

Administration in settlement of default claims on FHA-insured mortgages, and participation certificates issued in fiscal year 1968 by the predecessor of the Government National Mortgage Association.

The FFB conducts its borrowing activities under the authority of section 9 of the Federal Financing Bank Act of 1973. Section 9(a) authorizes the Bank to issue its obligations publicly, up to $15 billion outstanding at any one time. Since these obligations are not issued under the Public Debt Act or guaranteed within the meaning of the act, they are not subject to the public debt limit.

Section 9(b) of the FFB Act authorizes the Bank to issue obligations to the Treasury, and, in turn, authorizes the Treasury to use the proceeds from the sale of securities under the Public Debt Act to finance its purchases of FFB obligations. Thus, FFB borrowings from the Treasury, funded by Treasury's issuance of its own obligations, increase the debt subject to limit.

The original thinking, as evidenced by the legislative history of the FFB Act, for providing the FFB with dual borrowing authorities was that FFB would normally issue its obligations publicly under section 9(a), and that the authority to borrow from the Treasury under section 9(b) would be used as a backup or for interim financing between market borrowings. However, the initial FFB issue under section 9(a), an 8-month bill in the amount of $1.5 billion in July 1974, was not well-received by the market, despite an extensive selling effort. It was then decided that the Bank would henceforth finance its activities by borrowing from the Treasury under section 9(b), thereby reducing the Government's overall interest outlays. As a result, all FFB borrowing from 1975 until this October has been financed by debt subject to the debt limit.

Turning now to the use of the FFB section 9(a) borrowing authority to alleviate the debt limit crisis earlier this month, such use was prompted by inquiries from congressional staff as to the possibility of having the FFB issue its own securities in the market to raise cash. Yet, our use of the FFB borrowing authority under section 9(a) was reluctant.

First, in letters of October 1, 1985, to the Senate leadership urging prompt action on the debt limit legislation, Secretary Baker advised that use of the FFB for this purpose would raise two significant problems:

First, such action might be contrary to the intent of Congress that the FFB not be used to evade the purpose of the debt limit statute; and, second, an FFB issue in the market was a very costly means of financing compared to Treasury borrowing. We concluded that use of the FFB should be avoided for this purpose.

Next, in a letter of October 3 to the Senate majority leader, Secretary Baker warned that, "Unless a debt limit is passed by the Congress and signed into law by the President on or before October 7, 1985, or we take unprecedented and costly measures such as using the Federal Financing Bank borrowing authority, the United States could be in a position of defaulting on its obligations for the first time in history."

Again, in a letter of October 7 to the Senate majority leader urging action on the debt limit, Acting Secretary Darman repeated

this warning, characterizing use of the FFB as "unprecedented and questionable."

On October 8, the Department advised the Senate leadership of our projection of a zero cash balance for the end of that day, and, absent remedial action, a negative cash balance at the end of the following day, October 9. We also advised that the Department would announce its intention to offer $5 billion of Treasury bills to be auctioned on October 9.

Finally, on October 9, the Department advised the Senate that we would affirm our offer of $5 billion of bills for that day, and that we would use the FFB borrowing authority if necessary to facilitate this transaction. The announcement stated: "Only in the event that Congress fails to raise the current debt limit today will this procedure be used, in order to assure that the Government can raise cash in order to avoid default."

Mr. Chairman, for your reference, I have attached copies of these letters and announcements to my prepared statement.

The actual use of the FFB borrowing authority was in the nature of a swap, $5 billion of nonmarketable public debt securities held by the civil service retirement and disability fund were redeemed. This freed up a like amount of debt limit authority, allowing the issuance of the marketable bills auctioned and issued that day without exceeding the debt limit. The FFB obligations were issued to the fund later that day, without any loss of interest to the fund. Since the interest rate, 10.375 percent, and maturity, June 30, 1986, of the FFB securities issued to the civil service fund are identical to the interest rate and maturity of the redeemed nonmarketable securities, and since the rate on FFB obligations redeemed from the Treasury is the same rate, there will be no gain or loss to the civil service fund or the FFB as a result of this transaction.

As to other alternatives considered, on October 22, Secretary Baker advised the conferees on the debt limit legislation of the actions taken by this Department to avoid breaching the debt limit, including noninvestment of new transfers to the trust funds and costly delays of auctions of marketable Treasury securities. Secretary Baker also advised that we are reluctantly prepared to take the extraordinary step of disinvesting trust funds in advance of payment of benefits to permit payment of those benefits starting November 1. Finally, we have considered, and rejected, sale of U.S. gold holdings.

As to consequences of default, in testimony on September 10 and in the previously mentioned letters, Treasury has advised Congress that default would mean that recipients of checks for Social Security, payroll, unemployment, defense contract and other payments, including principal and interest on Treasury securities, would be unable to cash these checks. The full consequences of a default by the United States are impossible to predict and awesome to anticipate.

That concludes my prepared statement, Mr. Chairman. I will be happy to respond to your questions.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Niehenke with attachments follows:]

FOR RELEASE ON DELIVERY
EXPECTED AT 9:30 A.M.
October 31, 1985

STATEMENT OF JOHN J. NIEHENKE
ACTING ASSISTANT SECRETARY OF THE TREASURY
(DOMESTIC FINANCE)
BEFORE THE SUBCOMMITTEE ON ECONOMIC STABILIZATION
OF THE HOUSE BANKING, FINANCE AND URBAN AFFAIRS COMMITTEE

Mr. Chairman and Members of the Subcommittee:

It is a pleasure to be here this morning to discuss the use of the Federal Financing Bank to keep the Federal Government within the statutory ceiling on the public debt. You have asked for a discussion of the transactions which were made to stay within the debt limit, the reasons for using the FFB, the other alternatives that were considered, and the consequences of a possible default.

I would like to begin by briefly describing the statutory framework governing the borrowing operations of the Federal Government, including the borrowing activities of the FFB.

Treasury securities are issued under the authority of the public debt statutes (Chapter 31 of Title 31, United States Code). Treasury issues these securities to finance both budget and off-budget deficits, including the borrowing needs of the FFB, and to refund maturing debt. Treasury also issues securities to the various Government investment accounts and trust funds. The Act places a ceiling on the amount of outstanding obligations issued under the

Act, certain obligations fully guaranteed as to principal and interest by the United States (largely debentures issued by the Federal Housing Administration in settlement of default claims on FHA-insured mortgages), and participation certificates issued in fiscal year 1968 by the predecessor of the Government National Mortgage Association.

The FFB conducts its borrowing activities under the authority of section 9 of the Federal Financing Bank Act of 1973. Section 9(a) authorizes the Bank to issue its obligations publicly, up to $15 billion outstanding at any one time. Since these obligations are not issued under the public debt Act or guaranteed within the meaning of that Act they are not subject to the public debt limit.

Section 9(b) of the FFB Act authorizes the Bank to issue obligations to the Treasury, and, in turn, authorizes the Treasury to use the proceeds from the sale of securities under the public debt Act to finance its purchases of FFB obligations. Thus, FFB borrowings from the Treasury, funded by Treasury's issuance of its own obligations, increase the debt subject to limit.

The original thinking, as evidenced by the legislative history of the FFB Act, for providing the FFB with dual borrowing authorities was that FFB would normally issue its obligations publicly under section 9(a), and that the authority to borrow from the Treasury under section 9(b) would be used as a backup or for interim financing between market borrowings. However, the initial FFB issue under section 9(a), an 8-month bill in the amount of $1.5 billion in July 1974, was not well received by the market, despite an extensive

selling effort. It was then decided that the Bank would henceforth finance its activities by borrowing from the Treasury under section 9(b), thereby reducing the Government's overall interest outlays. As a result, all FFB borrowing from 1975 until this October has been financed by debt subject to the debt limit.

Turning now to the use of the FFB section 9(a) borrowing authority to alleviate the debt limit crisis earlier this month, such use was prompted by inquiries from Congressional staff as to the possibility of having the FFB issue its own securities in the market to raise cash. Yet, our use of the FFB borrowing authority under section 9(a) was reluctant.

First, in letters of October 1, 1985 to the Senate leadership urging prompt action on the debt limit legislation, Secretary Baker advised that use of the FFB for this purpose would raise two significant problems:

-- such action might be contrary to the intent of Congress that the FFB not be used to evade the purpose of the debt limit statute, and

-- an FFB issue in the market would be a very costly means of financing compared to Treasury borrowing.

We concluded that use of the FFB should be avoided for this purpose.

Next, in a letter of October 3 to the Senate Majority Leader, Secretary Baker warned that "unless a debt limit is passed by the Congress and signed into law by the President on or before October 7, 1985 or we take unprecedented and costly measures such as using the

Federal Financing Bank borrowing authority, the United States could be in a position of defaulting on its obligations for the first time in history."

Again, in a letter of October 7 to the Senate Majority Leader urging action on the debt limit, Acting Secretary Darman repeated this warning, characterizing use of the FFB as "unprecedented and questionable."

On October 8, the Department advised the Senate leadership of our projection of a zero cash balance for the end of that day, and, absent remedial action, a negative cash balance at the end of the following day, October 9. We also advised that the Department would announce its intention to offer $5 billion of Treasury bills to be auctioned on October 9.

Finally, on October 9, the Department advised the Senate that we would affirm our offer of $5 billion of bills for that day, and that we would use the FFB borrowing authority if necessary to facilitate this transaction. The announcement stated: "Only in the event that Congress fails to raise the current debt limit today will this procedure be used -- in order to assure that the Government can raise cash in order to avoid default."

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authority, allowing the issuance of the marketable bills auctioned and issued that day without exceeding the debt limit. The FFB obligations were issued to the fund later that day, without any loss of interest to the fund. Since the interest rate (10.375%) and maturity (June 30, 1986) of the FFB securities issued to the Civil Service Fund are identical to the interest rate and maturity of the redeemed non-marketable securities, and since the rate on FFB obligations redeemed from the Treasury is the same 10.375 percent, there will be no gain or loss to the Civil Service Fund or the FFB as a result of this transaction.

As to other alternatives considered, on October 22 Secretary Baker advised the conferees on the debt limit legislation of the actions taken by this Department to avoid breaching the debt limit, including non-investment of new transfers to the trust funds and costly delays of auctions of marketable Treasury securities. Secretary Baker also advised that we are reluctantly prepared to take the extraordinary step of disinvesting trust funds in advance of payment of benefits to permit payment of those benefits starting November 1. Finally, we have considered, and rejected, sale of United States gold holdings.

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securities, would be unable to cash these checks. The full consequences of a default by the United States are impossible to predict and awesome to anticipate.

That concludes my prepared statement, Mr. Chairman. I will be happy to respond to your questions.

Attachments

oOo

THE SECRETARY OF THE TREASURY
WASHINGTON

October 1, 1985

Dear Bob:

As I promised in my letter to you of September 25, this letter will update you on our current cash and debt estimates and thus our need for action by the Senate on legislation to increase the public debt limit.

Our current estimates still show that Treasury's cash balance will be virtually exhausted by October 7, and the situation will deteriorate sharply thereafter. Consequently, it is imperative that the Senate act on the debt limit bill by October 7. Also, as we informed you earlier, as of yesterday we have been unable to comply with statutory requirements to fully invest several trust funds, thus costing them interest earnings.

Congressional staff have inquired as to the possibility of having the Federal Financing Bank issue its own securities directly in the market as a means of raising cash while avoiding direct Treasury issues subject to the debt limit. I believe this approach presents two significant problems.

First, the legislative history of the Federal Financing Bank Act of 1973 raises questions as to whether such action would be contrary to the intent of Congress that the FFB not be used to evade the purpose of the debt limit statute. Second, it is clear that an FFB issue in the market would be a very costly means of financing, compared to Treasury borrowing, especially if such an FFB issue were required to be done on short notice without adequate market preparation. Thus a failure to act by October 7 would cost the taxpayers just as our inability to fully invest the trust funds is costing these funds right now. Hence, I believe we should avoid using the Federal Financing Bank borrowing authority for this purpose.

Accordingly, I continue to urge the Senate to act on the debt limit by October 7.

Sincerely,

James A. Baker, III

The Honorable Robert Dole
Majority Leader
United States Senate
Washington, D.C. 20510

THE SECRETARY OF THE TREASURY
WASHINGTON

October 1, 1985

Dear Senator Byrd:

As I promised in my letter to you of September 25, this letter will update you on our current cash and debt estimates and thus our need for action by the Senate on legislation to increase the public debt limit.

Our current estimates still show that Treasury's cash balance will be virtually exhausted by October 7, and the situation will deteriorate sharply thereafter. Consequently, it is imperative that the Senate act on the debt limit bill by October 7. Also, as we informed you earlier, as of yesterday we have been unable to comply with statutory requirements to fully invest several trust funds, thus costing them interest earnings.

Congressional staff have inquired as to the possibility of having the Federal Financing Bank issue its own securities directly in the market as a means of raising cash while avoiding direct Treasury issues subject to the debt limit. I believe this approach presents two significant problems.

First, the legislative history of the Federal Financing Bank Act of 1973 raises questions as to whether such action would be contrary to the intent of Congress that the FFB not be used to evade the purpose of the debt limit statute. Second, it is clear that an FFB issue in the market would be a very costly means of financing, compared to Treasury borrowing, especially if such an FFB issue were required to be done on short notice without adequate market preparation. Thus a failure to act by October 7 would cost the taxpayers just as our inability to fully invest the trust funds is costing these funds right now. Hence, I believe we should avoid using the Federal Financing Bank borrowing authority for this purpose.

Accordingly, I continue to urge the Senate to act on the debt limit by October 7.

Sincerely,

James A. Baker, III

The Honorable Robert C. Byrd
Minority Leader
United States Senate
Washington, D.C. 20510

THE SECRETARY OF THE TREASURY
WASHINGTON

October 3, 1985

Dear Bob:

I am writing to emphasize the need for final action by the Congress on debt limit legislation no later than October 7.

As I indicated in my letter to you on October 1, current projections indicate that Treasury's cash balance will be virtually exhausted by October 7 and the situation will deteriorate sharply thereafter.

This means that, unless a debt limit is passed by the Congress and signed into law by the President on or before October 7, 1985 or we take unprecedented and costly measures such as using Federal Financing Bank borrowing authority, the United States could be in the position of defaulting on its obligations for the first time in history.

If the debt limit is not increased by October 7, the Government likely will be unable to meet all of its essential obligations when they fall due including social security checks, payroll checks, unemployment checks, defense contracts, and principal and interest on its securities. The full consequences of a default by the United States are impossible to predict and awesome to anticipate.

I urge the Congress to pass this legislation at the earliest possible date but under no circumstances later than October 7, 1985.

Sincerely,

James A. Baker, III

The Honorable Robert Dole
Majority Leader
United States Senate
Washington, DC 20510

THE SECRETARY OF THE TREASURY
WASHINGTON

October 7, 1985

Dear Mr. Majority Leader:

In letters dated September 25, October 1, and October 3, Secretary Baker informed you of our projection that Treasury's cash balance would be virtually exhausted unless either the Congress acts to increase the debt limit by October 7, or we take unprecedented and questionable action to use Federal Financing Bank authority. This letter is to inform you of our latest cash projection -- and to repeat our request for Congressional action today.

As you know, we have already had to fail to meet certain requirements for the full investment of several trust funds -- costing them approximately $8 million per day. As of this morning, we estimated that cash balances may be zero or negative tomorrow, and will certainly be negative by Wednesday.

When we formally determine that the next day's balance is to be negative, we will need to notify the Federal Reserve. It is my understanding that, upon such notification, the Federal Reserve will then have to notify the banking system not to honor any Government checks or electronic fund transfers. (It is not appropriate or administratively practicable to attempt to distinguish among classes of payment obligations -- favoring some at the expense of others.) Accordingly, all those with federal payment claims -- whether social security recipients or defense contractors or holders of Government securities with interest payments due -- would then be unable to have those claims honored.

We continue to hope that the Congress will act promptly to avoid such an unprecedented failure of the U.S. Government to honor its obligations. If the Congress acts today, we would inform the financial markets by noon tomorrow of our intention to offer Treasury bills for sale on Wednesday. In anticipation of this financing, we and the Federal Reserve would then be able to manage payments on Tuesday so as to avoid a default.

In sum, unless a debt limit is passed promptly by the Congress or we take the unprecedented and questionable measure of using Federal Financing Bank borrowing authority, the United States would be in the position of defaulting on its obligations for the first time in history.

Sincerely,

Richard G. Darman
Acting Secretary

The Honorable Robert Dole
United States Senate
Washington, D. C. 20510

THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON

October 8, 1985

Dear Mr. Majority Leader:

This note is to provide you with our latest cash projection. As of this morning, we project an ending balance for October 8 (today) of zero; and -- absent remedial action -- a negative ending balance for October 9 (tomorrow).

We continue to hope that the Congress will act promptly to avoid the undesirable alternatives I referred to in my letter of October 7 (either unprecedented and questionable use of Federal Financing Bank authority, or an unprecedented default by the United States). Accordingly, at noon today Treasury will release the following public statement:

> "In hope that the Congress will act promptly to produce a satisfactory resolution of the current impasse concerning the statutory debt limit, the Treasury Department is today announcing its intention to offer $5 billion of Treasury bills to be auctioned on Wednesday, October 9, at 12:30 p.m."

In anticipation of action that would allow us to proceed with this financing, we and the Federal Reserve should be able to manage payments so as to avoid a default.

For all the obvious reasons, we again urge that the Congress act promptly to raise the current debt limit.

Sincerely,

Richard G. Darman

Richard G. Darman
Acting Secretary

The Honorable Robert Dole
United States Senate
Washington, D.C. 20510

FOR IMMEDIATE RELEASE October 8, 1985

TREASURY OFFERS $5,000 MILLION OF 78-DAY
CASH MANAGEMENT BILLS

In hope that Congress will act promptly to produce a satisfactory resolution of the current impasse concerning the statutory debt limit, the Treasury Department is today announcing its intention to offer $5,000 million of Treasury bills to be auctioned on Wednesday, October 9, at 12:30 p.m.

The Department of the Treasury, by this public notice, invites tenders for approximately $5,000 million of 78-day Treasury bills to be issued October 9, 1985, representing an additional amount of bills dated December 27, 1984, maturing December 26, 1985 (CUSIP No. 912794 EQ 0).

Competitive tenders will be received only at the Federal Reserve Bank of New York prior to 12:30 p.m., Eastern Daylight Saving time, Wednesday, October 9, 1985. Wire and telephone tenders may be received at the discretion of the Federal Reserve Bank of New York. Each tender for the issue must be for a minimum amount of $10,000,000. Tenders over $10,000,000 must be in multiples of $1,000,000. Tenders must show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions must not be used.

Noncompetitive tenders from the public will not be accepted. Tenders will not be received at the Department of the Treasury, Washington, or at any Federal Reserve Bank or Branch other than the Federal Reserve Bank of New York.

The bills will be issued on a discount basis under competitive bidding, and at maturity their par amount will be payable without interest. The bills will be issued entirely in book-entry form in a minimum denomination of $10,000 and in any higher $5,000 multiple, on the records of the Federal Reserve Banks and Branches. Additional amounts of the bills may be issued to Federal Reserve Banks as agents for foreign and international monetary authorities at the average price of accepted competitive tenders.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held as of 12:00 noon, Eastern time, on the day of the auction. Such positions would include bills acquired through "when issued" trading, futures,

THE SECRETARY OF THE TREASURY
WASHINGTON

October 9, 1985

Dear Bob:

The Federal Government's ending balance for October 8 was approximately three (3) million dollars. As of this morning, we project an ending cash balance for October 9 (today) that -- absent remedial action -- would be negative. This is exactly consistent with the forecasts provided to you in our letters of October 7 and 8.

We continue to hope that the Congress will act promptly to provide debt ceiling relief. Faced now, however, with the obviously undesirable possibility of an unprecedented default, we feel obliged to proceed with an auction of Treasury bills on the basis outlined by the following statement, which we intend to make public at 11:00 a.m. this morning:

> "The Treasury Department will conduct the auction of 78-day cash management bills as announced on October 8. We continue to hope that the Congress will act to raise the debt limit in order to allow this auction to proceed to closure without the use of Federal Financing Bank (FFB) authority. If, however, the Congress fails to raise the debt limit, Treasury will use FFB borrowing authority (which is not subject to debt limit) to issue FFB securities to substitute for existing non-marketable Treasury debt. Treasury will redeem the non-marketable debt in an amount sufficient to permit issuance of the Treasury bills being auctioned today. Accordingly, these securities will be backed by the full faith and credit of the United States and will be within the current applicable debt limit. Only in the event that Congress fails to raise the current debt limit today will this procedure be used -- in order to assure that the Government can raise cash in order to avoid default."

As I indicated in my October 1 letter to you, we are reluctant to use the Federal Financing Bank authority in the manner that will be required -- in order to avoid default -- if the Congress does not raise the debt ceiling today. We appreciate that some members of Congress are similarly reluctant to see this FFB authority used. So, I again respectfully urge that the Congress act to relieve the current debt limit today.

Sincerely,

James A. Baker, III

The Honorable Robert Dole
United States Senate
Washington, D.C. 20510

FOR IMMEDIATE RELEASE October 9, 1985

TREASURY AFFIRMS OFFER OF $3,000 MILLION
OF 78-DAY CASH MANAGEMENT BILLS

The Treasury Department will conduct the auction of 78-day cash management bills as announced on October 8. We continue to hope that the Congress will act to raise the debt limit in order to allow this auction to proceed to closure without the use of Federal Financing Bank (FFB) authority. If, however, the Congress fails to raise the debt limit, Treasury will use FFB borrowing authority (which is not subject to the debt limit) to issue FFB securities to substitute for existing nonmarketable Treasury debt. Treasury will redeem the nonmarketable debt in an amount sufficient to permit issuance of the Treasury bills being auctioned today. Accordingly, these securities will be backed by the full faith and credit of the United States and will be within the current applicable debt limit. Only in the event that Congress fails to raise the current debt limit today will this procedure be used in order to ensure that the Government can raise cash in order to avoid default.

FOR IMMEDIATE RELEASE October 9, 1985

RESULTS OF TREASURY'S AUCTION
OF 78-DAY CASH MANAGEMENT BILLS

The Treasury has accepted $5,010 million of the $16,279 million of tenders received at the Federal Reserve Bank of New York for the 78-day Treasury bills to be issued October 9, 1985, and to mature December 26, 1985, auctioned today. The range of accepted bids was as follows:

	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)	Price
Low	7.20%	7.42%	98.440
High	7.25%	7.47%	98.429
Average	7.23%	7.44%	98.434

Tenders at the high discount rate were allotted 48%.

THE SECRETARY OF THE TREASURY
WASHINGTON

October 22, 1985

Dear Bill:

As you participate in the conference on H.J. Res. 372 to increase the debt limit, I want to bring you up to date on where we stand and what actions Treasury will and will not take. We find ourselves in a position where continued Congressional inaction has moved the Treasury's position from sound financial management to unnecessary crisis management. I hope that a full explanation of our projections and intentions will allow responsible action to avoid a costly continuation of this unseemly situation. By so acting, the United States will once again be able to raise funds to meet its lawful obligations without engaging in activities that erode confidence in our financial system.

Contrary to some assertions, Treasury's cash and debt projections and other information provided to the Congress since early September have been very accurate. In testimony on September 10, Treasury informed Congress that failure to pass a debt limit extension would result in our (1) reaching the debt ceiling and (2) becoming unable to invest fully several trust funds starting on September 30, with a consequent loss of interest to those funds. In a series of letters starting September 25, we warned Congress that our cash balances would be virtually exhausted on October 7, reaching a zero or negative balance on October 8. The testimony and letters predicted exactly what actually happened. In those same letters, we stated our strong reluctance to adopt the suggestion of Congressional staff that we use the Federal Financing Bank's non-debt-limit borrowing authority, calling such an action "unprecedented and questionable." We made clear, also, that if the Congress failed to act on the debt ceiling, we would have to choose between the FFB option and an unprecedented United States government default. Faced with Congressional inaction and the prospect of certain default on October 9, we used $5 billion of the FFB authority.

We have taken every action ever used by this Department to raise cash within the debt limit. Moreover, we have taken the additional step of using the FFB's borrowing authority to avoid default. These actions have not been without costs. Since September, the failure of Congress to increase the debt limit has resulted in non-investment of trust funds, costly delays of auctions, and uncertainty throughout the capital markets. Over $50 billion of financing that would otherwise have taken place over several months beginning in September is now confronting the markets. The uncertainty and delay will likely cost the American taxpayer millions of dollars.

Our current cash projections indicate that even if we use the remaining $10 billion FFB borrowing authority, we will have a negative balance on November 1, widening to a negative balance of over $5 billion by November 4. I intend to use the FFB borrowing authority, again reluctantly. But you should be aware that, subject to estimating error, it cannot get us through November 1. The negative numbers starting on November 4, moreover, are so large as to be outside the margin of error.

Some Members of Congress have suggested that, in order to provide Congress with yet more time, we should take the further extraordinary step of disinvesting trust funds (social security, military retirement, civil service retirement, and railroad retirement) in advance of payment of benefits to permit payment of those benefits starting November 1. (This option was not available on October 8, as October benefits had already been paid.) Taking this action will result in additional interest loss to the funds and further frustration of our financing schedule. Moreover, it may raise questions in the minds of present and future recipients of trust fund benefits--principally pensioners--about why they have become involved in the debt limit process. Nevertheless, having discussed this matter with the President and the Attorney General, we are reluctantly prepared to take this action on October 31 if Congress once again fails to act to resolve the debt limit impasse.

It is essential that Congress recognize that, even if trust funds were disinvested to avoid a November 1 default, we would certainly default on November 15 unless Congress acted before then to increase the debt limit. That default, which would involve reneging on the principal and interest of United States securities held by both Americans and foreigners, would have swift and severe domestic and international repercussions. No longer would investors view United States securities as riskfree, and a substantial financing price would have to be paid. Any increase in the benchmark Treasury rate would probably adversely affect general interest rates, with negative effects on both the deficit and the economy.

I have spent the past week reviewing the known legal and practical options and have concluded that there are no means available to avoid default that would not be a stark evasion of the debt limit statute--with the possible exception of the sale of United States gold holdings. The President and I are not prepared to take that step because it would undercut confidence here and abroad based on the widespread belief that the gold reserve is the foundation of our financial system, and because the Congress clearly has the power to prevent a default by assuming its responsibility with respect to the debt limit.

I sincerely hope you will take prompt action to avoid further exacerbation of this unnecessary and unfortunate situation.

Sincerely,

James A. Baker, III

The Honorable William H. Gray, III
U.S. House of Representatives
Washington, D. C. 20515

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

October 30, 1985

Dear Mr. Chairman:

In response to your request this morning, enclosed is a memorandum that concludes that, under the Social Security Act, the Secretary of the Treasury (i) has the authority to disinvest securities held by the Social Security trust funds in order to pay benefits, (ii) has the authority, at this time, to make those funds whole for direct interest losses arising from failure to invest according to the Act's normalized tax transfer provisions, but (iii) does not have the authority to make any trust or retirement fund whole for any other interest loss.

Sincerely,

Bruce E. Thompson, Jr
Assistant Secretary
(Legislative Affairs)

The Honorable
James R. Jones, Chairman
Subcommittee on Social Security
Committee on Ways and Means
House of Representatives
Washington, DC 20515

Enclosure

cc: The Honorable
Bill Archer
House of Representatives
Washington, DC 20515

Authority to Redeem Trust Funds to Pay Benefits

Under Section 201(d) of the Social Security Act (the "Act"), the Secretary of the Treasury is required to invest the excess balances in the Federal Old Age and Survivors Insurance Trust Fund and the Federal Disability Insurance Trust Fund (the "Trust Funds"). The types of investments permitted, and the required interest rate for obligations issued to the Trust Funds by the Secretary, are also explicitly set forth in the Act. All Treasury interest-bearing obligations issued to the Trust Funds are obligations subject to the limit on the public debt. 201(d) of the Act; 31 U.S.C. 3101.

Section 201(e) of the Act authorizes the Secretary to redeem Trust Fund investments. Sections 201(f) and (h) of the Act provide that the proceeds of redemption are to become part of the Trust Funds and that the Trust Funds are to be used to pay benefits.

The Secretary is therefore responsible both for investment and redemption of the Trust Funds in order to pay benefits. When the Trust Funds cannot be used to pay benefits because cash is unavailable as a result of Treasury's inability to issue new debt in the market, the Secretary may use the section 201(e) redemption authority to change the normal timing of redemptions in order to make certain that cash can be raised so that the Trust Funds can be used for the purpose for which they were created--to pay benefits.

The accounting system under which investments and redemptions are made has been established over a number of years in conformity with the requirements of section 201, and is explicitly referenced in section 201(a). The normal redemption procedure is to redeem first securities maturing on the upcoming June 30, lowest interest rate first. When there are no more such securities, securities maturing on the next June 30, lowest interest rate first are redeemed, and so on. When projected monthly tax receipts do not equal or exceed benefit payments, the standard investment and redemption procedure results in the redemption of long-term securities (those with an original maturity of one year or more) to pay benefits. This has been done any number of times over the last several years, most recently (and not for debt limit purposes) in August, 1985.

Making the Funds Whole

The question of making the trust funds whole has two aspects: (1) interest loss to the Social Security and Disability trust funds due to non-investment of the normalized tax transfer (NTT); and (2) losses to all funds due to other non-investments and to redemption, out of the normal order, of long term securities that may, depending on interest rate movements, carry a higher interest rate than their replacements.

1. Social Security and Disability

The NTT procedure under section 201(a) of the Act provides that the Secretary must transfer to the Trust Funds on the first of each month an amount equal to projected FICA tax receipts for that month. This procedure was established in the 1983 Social Security Act Amendments, and was meant to provide a cash flow, not a net interest benefit to the Trust Funds. H. Rep. No. 98-25, Pt. 1 at 36 (1983). Therefore, section 201(a) further provides that investment is to be made "in the same manner and to the same extent as the other assets in such Trust Fund" and that excess interest earned because of the early transfer must be reimbursed to the Treasury general fund. Investment of the NTT was to be made (except for timing) as had been the case prior to 1983. Section 201(a); H. Rep. No. 98-25, Pt. 1, at 36 (1983). (An attempt to change the investment system in the 1983 amendments failed.)

Interest is credited to the Trust Funds semiannually, as it has been for many years. It is during this semiannual interest crediting that the excess interest earned due to the normalized tax transfer is netted against the actual interest credit. During periods that Treasury has not had sufficient authority under the debt limit to fully invest the NTT, less interest is earned and therefore less excess interest is due to the general fund. The semiannual interest credit procedure means that non-investment of the NTT, taken by itself, has not resulted in a loss of interest to the Social Security and Disability Trust Funds; however, in the current situation, the non-investment of the NTT has gone on for long enough to have had a collateral effect which will result in both an immediate and a potentially greater long term loss of interest starting on November 1.

To pay benefits Treasury has been required to redeem securities out of the normal order. This has meant that longer term securities with interest rates equal to the current investment interest rate have been redeemed that, given current flows of taxes and benefit payments, normally would not have been so redeemed. There will be a similar effect if the program described in Secretary Baker's October 22 letter is implemented. In addition, some longer term securities with interest rates slightly in excess of the current investment interest rate will be redeemed, thereby leading to an immediate loss of interest over what would have been the case had the funds been fully invested.

Treasury's authority to issue debt to the Trust Funds is limited to either special investments at the interest rate specified in section 201(d) of the Social Security Act or, if the Secretary makes a public interest determination, to marketable obligations at current interest rates. Treasury does not have the authority to reissue at the same interest

rate the redeemed longer-term special securities or to transfer revenues to the Trust Funds equivalent to the interest not earned during the period of redemption.

2. Other Funds

It should be noted that the Civil Service Retirement and Disability Fund, the Federal Supplementary Medical Insurance Trust Fund, the Railroad Retirement Account, and the Department of Defense Military Retirement Fund also have uninvested balances as a result of the failure to increase the debt limit which have resulted in a loss of interest to those funds. Moreover, some of these funds have been forced to redeem longer term securities in an abnormal order. As with the Social Security and Disability Trust Funds, Treasury does not have the authority to reissue at the same interest rate the redeemed obligations or to transfer amounts to these funds equal to interest not earned.

Chairman LAFALCE. Thank you very much.

Before we ask questions, though, we will hear from all the panelists, and because it would be helpful for the subcommittee to have a presentation on the legality of the transactions, we will next call on the representative from GAO, Mr. Havens.

STATEMENT OF HARRY S. HAVENS, ASSISTANT COMPTROLLER GENERAL, U.S. GENERAL ACCOUNTING OFFICE

Mr. HAVENS. Thank you, Mr. Chairman.

I have no prepared statement. We have rendered an opinion on the issue that you posed to us, and that opinion has been delivered to the committee. I might make a few remarks to summarize the nature of that opinion.

Chairman LAFALCE. Since it was not delivered until 7 last night and I left at about 6:30, I have not had a chance to read it. I wonder if you could read that letter, it is not that long.

Mr. HAVENS. This is in the form of a letter to you, Mr. Chairman.

You have requested our opinion on the legality of the transactions on October 9, 1985, by which the Department of the Treasury, through use of the borrowing authority of the Federal Financing Bank, was able to obtain $5 billion without exceeding the statutory limit on the public debt.

Because of the urgency of your request, we were unable to seek the formal views of either Treasury or the bank. For reasons we shall explain below, we conclude that the transactions in question were legal.

THE FACTS

On October 9, 1985, the Department of the Treasury had borrowed the maximum amount permitted by 31 U.S.C., section 3101, formerly the Second Liberty Bond Act. Treasury thus faced the prospect of defaulting on obligations of the United States because revenues were insufficient to meet all obligations falling due.

To avoid default, the Secretary of the Treasury, acting both as Secretary and as chairman of the board of directors of the bank, effected the following transactions:

One, the Federal Financing Bank issued $5 billion in its securities to the Civil Service Retirement and Disability Fund.

Two, in payment for its securities, the bank accepted $5 billion in Treasury obligations from the retirement fund.

Three, the bank used the Treasury securities to prepay $5 billion of its outstanding debt to the Treasury.

Four, Treasury issued and sold to the public $5 billion in short-term obligations.

The result of these transactions was that Treasury obtained $5 billion with which to meet the obligations of the United States.

The Federal Financing Bank was created in 1973 as an instrumentality of the United States, operating under the general supervision and direction of the Secretary of the Treasury. See 12 U.S.C. section 2283. The bank's major function is to loan money to Federal agencies, by purchasing obligations issued, sold or guaranteed by those agencies. (12 U.S.C. section 2285.)

The bank may obtain funds for these purposes either by borrowing from the public or from Treasury (12 U.S.C. section 2288.) The bank's activities are not included in the annual budget of the United States (12 U.S.C. section 2290(c)).

The first two of the transactions on October 9, in effect, amounted to the bank exchanging its own securities for Treasury obligations held by the retirement fund. The net result was that the bank was borrowing $5 billion from the retirement fund.

We find nothing improper in the bank borrowing from the retirement fund. Subsection 9(a) of the Federal Financing Bank Act of 1973, 12 U.S.C. section 2288(b), authorizes the bank to issue up to $15 billion of obligations publicly, and subsection 9(d), 12 U.S.C. section 2288(d), provides that the bank's obligations "shall be lawful investments, and may be accepted as security for all fiduciary, trust and public funds, the investment of which shall be under the authority or control of the United States."

With respect to the third and fourth transactions, when the bank prepaid $5 billion of its debt with Treasury's own obligations, Treasury's outstanding debt was reduced by $5 billion. Therefore, Treasury was able to borrow an additional $5 billion from the public.

In our opinion, the legality of the Secretary's actions on October 9 depends solely on whether the bank's borrowing from the retirement fund counts against the statutory limit on the public debt.

The limit is contained in 31 U.S.C. section 3101(b), which provides as follows, and I quote:

> The face amount of obligations issued under this chapter and the face amount of obligations whose principal and interest are guaranteed by the U.S. Government, except guaranteed obligations held by the Secretary of the Treasury, may not be more than $1,575,700,000,000 or $1,823,800,000,000 on and after October 1, 1984, outstanding at any one time.

Since bank obligations are not issued under chapter 31 of title 31, they would count against the debt limit only if they are guaranteed by the United States both as to principal and interest.

The Federal Financing Bank Act of 1973 does not specifically provide that obligations issued to the public by the bank are guaranteed by the United States. Section 9(a) of the act, 12 U.S.C. section 2288(a), under which the bank borrows from the public, and in this case the authority for its borrowing from the retirement fund, merely states:

> The Bank is authorized, with the approval of the Secretary of the Treasury, to issue publicly and have outstanding at any one time not in excess of $15 billion of obligations having such maturities and bearing such rate or rates of interest as may be determined by the Bank.

We have examined the legislative history of the act and have found no indication that the Congress intended that the principal and interest of bank obligations issued under section 9(a) were to be guaranteed by the United States.

Based on the language of the Federal Financing Bank Act of 1973 and its legislative history, we conclude that bank borrowing from the public under subsection 9(a) is not subject to the statutory limit on the public debt.

Our conclusion is consistent with the views we expressed in the report of our audit of the bank's operations for fiscal year 1975 and 1976. Although written in the context of the bank borrowing to finance its own operations, we stated:

> However, if the debt ceiling were in danger of being reached, the Bank could sell its own securities, which are not subject to the debt ceiling.

We made a similar statement at another point on page 10 of the same report.

We trust that this opinion is responsive to your needs. Unless it is released earlier, or you inform us otherwise, this opinion will be available to the public 30 days from today.

Sincerely yours, Comptroller General of the United States.

Chairman LAFALCE. Thank you very much. Before I asked you to read that letter, you were about to make some comments?

Mr. HAVENS. My only comments were to summarize the letter in brief. I have nothing to add.

[The following letter was received by the subcommittee from the General Accounting Office for inclusion in the record:]

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-138524

OCT 7 1985

The Honorable John J. LaFalce, Chairman
Subcommittee on Economic Stabilization
Committee on Banking, Finance and Urban Affairs
House of Representatives

Dear Mr. Chairman:

You have requested our opinion on the legality of the transactions on October 9, 1985, by which the Department of the Treasury, through use of the borrowing authority of the Federal Financing Bank, was able to obtain $5 billion without exceeding the statutory limit on the public debt. Because of the urgency of your request, we were unable to seek the formal views of either Treasury or the Bank. For reasons we shall explain below, we conclude that the transactions in question were legal.

The Facts

On October 9, 1985, the Department of the Treasury had borrowed the maximum amount permitted by 31 U.S.C. § 3101 (formerly the Second Liberty Bond Act). Treasury thus faced the prospect of defaulting on obligations of the United States because revenues were insufficient to meet all obligations falling due. To avoid default, the Secretary of the Treasury, acting both as Secretary and as Chairman of the Board of Directors of the Bank effected the following transactions:

1. The Bank issued $5 billion in its securities to the Civil Service Retirement and Disability Fund.

2. In payment for its securities, the Bank accepted $5 billion in Treasury obligations from the Retirement Fund.

3. The Bank used the Treasury securities to prepay $5 billion of its outstanding debt to the Treasury.

4. Treasury issued and sold to the public $5 billion in short term obligations.

The result of these transactions was that Treasury obtained $5 billion with which to meet the obligations of the United States.

Discussion

The Federal Financing Bank was created in 1973 as an instrumentality of the United States, operating under the general supervision and direction of the Secretary of the Treasury. See 12 U.S.C. § 2283. The Bank's major function is to loan money to Federal agencies, by purchasing obligations issued, sold or guaranteed by those agencies. 12 U.S.C. § 2285. The Bank may obtain funds for these purposes either by borrowing from the public or from Treasury. 12 U.S.C. § 2288. The Bank's activities are not included in the annual budget of the United States. 12 U.S.C. § 2290(c).

The first two of the transactions on October 9, in effect, amounted to the Bank exchanging its own securities for Treasury obligations held by the Retirement Fund. The net result was that the Bank was borrowing $5 billion from the Retirement Fund.

We find nothing improper in the Bank borrowing from the Retirement Fund. Subsection 9(a) of the Federal Financing Bank Act of 1973, 12 U.S.C. § 2288(b), authorizes the Bank to issue up to $15 billion of obligations "publicly," and subsection 9(d), 12 U.S.C. § 2288(d), provides that the Bank's obligations "shall be lawful investments, and may be accepted as security for all fiduciary, trust, and public funds, the investment of which shall be under the authority or control of the United States * * *."

With respect to the third and fourth transactions, when the Bank prepaid $5 billion of its debt with Treasury's own obligations, Treasury's outstanding debt was reduced by $5 billion. Therefore, Treasury was able to borrow an additional $5 billion from the public.

In our opinion the legality of the Secretary's actions on October 9 depends solely on whether the Bank's borrowing from the Retirement Fund counts against the statutory limit on the public debt. The limit is contained in 31 U.S.C. § 3101(b), which provides:

> "The face amount of obligations issued under this chapter [31 U.S.C., Chapter 31] and the face amount of obligations whose principal and interest are guaranteed by the United States Government (except guaranteed obligations held by the Secretary of the Treasury) may not be more than $1,575,700,000,000, or $1,823,800,000,000 on and after October 1, 1984, outstanding at any one time * * *." (Emphasis added.)

Since Bank obligations are not issued under Chapter 31 of Title 31, they would count against the debt limit only if they are guaranteed by the United States both as to principal and interest.

The Federal Financing Bank Act of 1973 does not specifically provide that obligations issued to the public by the Bank are guaranteed by the United States. Section 9(a) of the Act, 12 U.S.C. § 2288(a), under which the Bank borrows from the public, and in this case the authority for its borrowing from the Retirement Fund, merely states:

> "The Bank is authorized, with the approval of the Secretary of the Treasury, to issue publicly and have outstanding at any one time not in excess of $15,000,000,000 * * * of obligations having such maturities and bearing such rate or rates of interest as may be determined by the Bank."

We have examined the legislative history of the Act and have found no indication that the Congress intended that the principal and interest of Bank obligations issued under section 9(a) were to be guaranteed by the United States.

Based on the language of the Federal Financing Bank Act of 1973 and its legislative history, we conclude that Bank borrowing from the public under subsection 9(a) is not subject to the statutory limit on the public debt.

Our conclusion is consistent with the views we expressed in the report of our audit of the Bank's operations for fiscal year 1975 and 1976. Although written in the context of the Bank borrowing to finance its own operations, we stated:

> "However, if the debt ceiling were in danger of being reached the Bank could sell its own securities, which are not subject to the debt ceiling." GAO, Audit of Financial Statements of the Federal Financing Bank--Fiscal Years 1975 and 1976 at 5 (GGD-77-36, B-174958, April 27, 1977).

We made a similar statement on page 10 of the same report.

B-138524

We trust that this opinion is responsive to your needs. Unless it is released earlier, or you inform us otherwise, this opinion will be available to the public 30 days from today.

Sincerely yours,

Milton J. Socolar

for Comptroller General
of the United States

Chairman LAFALCE. We will now hear from Edward P. Snyder, vice president of the National Bank of Detroit, but prior to that, holding positions that had to deal with the Federal Financing Bank in the Treasury Department.

He has some very interesting testimony—at least I found it interesting when I read it last night.

STATEMENT OF EDWARD P. SNYDER, VICE PRESIDENT, NATIONAL BANK OF DETROIT, FORMER SENIOR ADVISER FOR DEBT RESEARCH, DEPARTMENT OF THE TREASURY

Mr. SNYDER. You do have copies of my prepared statement, and I would be happy to submit those for the record. I perhaps can simply summarize them here in the interest of time.

To begin, I deplore the use of the Federal Financing Bank to circumvent the debt limit. The action, as indicated by the GAO, was perfectly legal, but it seemed to me has unnecessarily provided some additional ammunition to the people who are opponents of the Federal Financing Bank.

I believe the Financing Bank is a useful institution which has reduced the cost of Federal credit programs and improves the data available to Congress with respect to these programs.

Putting the FFB on budget, it seems to me, would renew the political pressures for excessive costly asset sales and expanded guarantee programs.

With regard to the specific issue, the debt limit, the Secretary of the Treasury is between a rock and a hard place. He has no discretion with respect to which payments will be made from his available moneys.

Consequently, the present impasse on the debt limit carries a real potential for a default. This would lead to considerable financial chaos, particularly with respect to foreign investors in U.S. Government securities.

I come to the conclusion that the debt limit itself is an anachronism in view of the additional budget procedures which Congress adopted in recent years, and it is hoped that this committee might be able to persuade their colleagues on the Ways and Means Committee to amend the Second Liberty Bond Act.

Disinvestment of the trust funds is no real threat to the beneficiaries of funds. The solvency of the funds depends upon the solvency of the United States, which is imperiled unless the Secretary takes appropriate actions, and in the event of any loss of interest because of the disinvestment approach, Congress can provide appropriations to make good on those amounts.

A question was raised at one point in conversations with your staff on how far disinvestment might carry the Government without action on the debt limit. The answer is probably something like 18 months, at which time there will be a new Congress which can then deal with the problem.

I might also observe that in my judgment, the balanced budget amendment is upside-down economics. The real issue before the Congress, the executive and the American public is the level of Federal outlays.

And with that, I think I have summarized my major points. Thank you.

[The prepared statement of Mr. Snyder follows:]

Statement by
Edward P. Snyder, Vice President, National Bank of Detroit
Before the House Banking Committee
Thursday, October 31, 1985

I appreciate the opportunity to appear before this distinguished Committee.

To identify myself, I have, for the past six years, been Director, Fixed Income Investment Department, Trust Investment Division, National Bank of Detroit. But, I should make it clear that I am not testifying as a representative of NBD or of any other organization.

Prior to joining NBD, I served in Washington for some twenty-eight years, of which eight were with the Board of Governors of the Federal Reserve System and twenty were with the Department of the Treasury.

The larger part of any expertise I bring to the subject before this panel derives from my years of service in the Treasury Department, lastly as Senior Adviser for Debt Research, in which capacity I contributed, and I hope significantly, to the development of the overall financing strategy which the Treasury continues to follow to this day.

At an earlier stage in my Treasury career, as Deputy Director of the Office of Debt Analysis, I participated, along with R. Duane Saunders, the then Director of that Office, in developing and perfecting the idea which led to the legislation creating the Federal Financing Bank.

Subsequently, I also worked closely with my good friend, Roland C. Cook, the first head of the Federal Financing Bank, in devising the policies and procedures which control the present operations of the Federal Financing Bank.

Although the employment of the Federal Financing Bank to circumvent the limitations on Treasury financing imposed by the current inadequate debt limit involved no illegality, I deplore both the situation that led to this action and the action itself.

Use of the Federal Financing Bank to finance the day-to-day operations of the Federal Government at a time when the debt subject to limit is close to or at the statutory ceiling was dealt with authoritatively when the Congress enacted the FFB legislation.

The Conference Committee report, in responding to the question raised during the debate, states quite plainly that the Bank would not be used for such a purpose.

The same worry was also the reason for an initial $15 billion limit on the amount of Federal Financing Bank obligations that might be outstanding at any time, outside the Treasury. While it was contemplated that the limit would be increased from time to time, this was to be only as needed to finance Federal credit programs. Such need never arose because the Treasury Department decided at an early stage that the FFB should borrow solely from the Treasury Department.

The reason was simple. The first Federal Financing Bank issues could not be marketed except at higher yields than those on comparable Treasury issues, and the Treasury concluded that there was no urgent reason to incur the expense of establishing a better market for the Bank's securities when a simpler alternative was available under the law.

The rationale for the Federal Financing Bank as well as the answer to the question whether the Federal Financing Bank should be brought "on budget" lie in history.

The Committee is familiar with the wide range of Federal credit programs, both guarantee and direct loan programs, which utilize the credit of the United States to support the financing of private individuals and businesses.

Especially with regard to the guarantees, we often hear the phrase, "the full faith and credit of the United States." A number of Attorney Generals have decried this terminology, since every contract lawfully entered into by a Federal agency binds the Federal Government in the same manner as any other such agreement.

That is, there is no difference in the legal standing of a claim by a contractor for moneys owed for work performed, an employee for salary earned, an annuitant for an entitled pension payment, or a bondholder for interest and principal due.

The point -- as Secretary Fowler, a distinguished Virginia lawyer, a great Secretary of the Treasury, and a leader of the Democratic Party testified before the Ways and Means Committee -- is that no legitimate money claim against the Government has any precedence or priority over any other legitimate money claim. Hence, moneys raised by a Treasury financing cannot be dedicated to the retirement of maturing debt or the payment of interest on outstanding debt to avoid a default if there are, at the same time, other outstanding money claims on the United States.

The present impasse in the debt limit legislation, therefore, could embody a real risk of causing a default on public debt obligations of the United States.

The Federal Financing Bank was intended to serve two purposes, and two purposes only. The first was to reduce the cost of Federal credit programs. The second was to facilitate their overall review and control by bringing together in one accessible place the necessary information on these programs.

Before the creation of the Federal Financing Bank, there was substantial volume of a variety of Federally-backed loans in the market. Some of these had been originated by private lenders with a guarantee by the Government. Others were loans originated by a Federal agency and later sold to private investors with a Government guarantee.

Put plainly, these guarantees of privately-originated loans and market sales by Federal agencies of their direct loans were mainly intended to minimize Federal outlays through deceptive budgeting techniques.

Guarantees do not appear as expenditures in the Federal budget, except as defaults lead to payments on such guarantees, and sales of assets are treated as negative expenditures, offsetting the outlays recorded at the time the loans were initiated.

For a variety of reasons -- the quality of the various guarantees, the terms of the loans, the amounts, and other factors affecting their marketability -- guaranteed obligation typically carried, and still carry, yields in excess, and often well in excess, of yields on direct obligations of the Treasury.

This might be of less concern if borrowers under these programs paid the full cost of the credit and defaults were minimal -- even though lenders might often earn an above-market rate considering the risk they assume -- but many of these loans were and are made at below market subsidy rates, so that inefficient financing results in clearly identifiable excess costs.

Financing these loans through the Federal Financing Bank at the Treasury's cost of money minimizes the net expense of these programs to the Government and the American taxpayers.

However, if the financing activities of the Federal Financing Bank should be treated as budget outlays -- the consequence of putting the Federal Financing Bank "on budget" -- the political pressures for loan guarantees and asset sales at unnecessary and excessive costs would be renewed. That, I believe, would be a retreat from sound policy.

Moreover, it is wholly appropriate to treat an exchange of financial assets -- a loan of money in exchange for a borrower's note -- as a balance sheet item, rather than an income statement item. Consequently, since the Budget of the United States is an income statement or, perhaps I should say, an outgo statement, it is appropriate that loan activities be recorded elsewhere.

There are, however, grave problems with extending balance sheet accounting beyond this limit.

In my Treasury career during the Kennedy Administration I was privileged to be a member of a fact finding group that visited several nations in which balance sheet accounting by one name or another was employed with unfortunate, at best, fiscal consequences. Closer at home, we have only to recall New York City's financial crisis, which resulted from shifting current outlays to a capital budget to make it appear appropriate to finance them by borrowing.

I wish that the Treasury had not used the Federal Financing Bank to bridge this period in which the debt ceiling is insufficient to cover the financial needs of the Government, as these have been determined by the Congress and assented to by the President.

I am jealous of the reputation of the Federal Financing Bank. I think it is a worthwhile bookkeeping fiction that should be kept out of the present political debate. And, I object to giving opponents of the Federal Financing bank additional arguments.

Nonetheless, I applaud the Treasury for adopting a technique -- that is, the swapping of securities held by trust funds -- which avoided unnecessary costs and had no adverse market impact.

Having personally suffered through a succession of debt limit crises, I can understand the decision of the present Treasury Secretary who, in his ministerial function as the paymaster for the United States, is caught on the horns of a dilemma: Should he fail to pay the legally incurred obligations of the United States, with consequent serious harm to the economy and the financial system, or should he violate the law or the spirit of law by taking steps to avoid these real costs at the potential expense of creating a field day for demagoguery?

If I were your Secretary of the Treasury and had this choice, I would follow the second course without a moment's hesitation, and I would do it with a clean conscience.

As Director, Fixed Income Investment Department, Trust Division, National Bank of Detroit, I am responsible for the investment of over $4-1/2 billion in discretionary fixed income assets.

In this highly competitive area, my policy and the policy of NBD has been to achieve investment returns without taking excesssive credit or market risks. I have, therefore, used high proportion of Government and sponsored agency securities in both my individually managed portfolios and commingled and common trust funds, and it is gratifying that this policy for all periods over the past five years has given us investment results, as measured by SEI Funds Evaluation Service, which have been above the median of all managers.

But market confidence is a fragile thing.

Several years ago, when a delay in Congressional action was in prospect, I instructed my bond traders not to buy Treasury bills that would mature in the month following expiration of the temporary debt limit.

I know a money manager who will now not buy or hold any Treasury obligations because of his concern about effects of inaction on the debt limit on the credit of the United States.

I have sold all Farm Credit System obligations in accounts for which I have investment discretion and I have significantly reduced my holdings of Federal Home Loan Bank obligations having more than a few months to run to maturity. Neither the Congress nor the Executive has given me any assurance that Government sponsorship assures timely action to cure the problems of these sponsored enterprises and, meanwhile, I see a deterioration in their financial ratios reflected in widening yield spreads.

Apart from my own concerns, the present investment guidelines of many of my clients would prohibit any investment in Treasury or other Goverment obligations for periods up to five years from the time of any default even a default for so short a period as one day.

From these kinds of concerns investors, both domestic and foreign, would flee from the Government bond market if there were a default, and confidence in the credit of the United States would only painfully be restored.

But it is a hopeful sign that both the House and the Senate appear to look with equanimity on a new debt limit of $2 trillion.

I will not estimate the thickness of two trillion dollar bills piled one on another or their length placed end-to-end, but this new attitude might auger well for a simple amendment to the Second Liberty Bond Act which would eliminate the need for periodic reconsideration of the debt limit, always an ultimately futile exercise, and allow the Congress to focus on the real problems that face our Nation, including how to control the future growth of expenditures.

Balanced budget legislation, such as embodied in the Gramm-Rudman-Hollings amendment, however, is ultimately nothing more than a pious expression by one Congress of hope that the next will be more responsible. Progress toward controlling budget outlays will only be achieved when the sitting Congress in some year finally decides to abolish or cut back meaningfully on programs which are obsolete or inefficient, of low priority, or even perverse.

As an economist, I would be amiss in not emphasizing to this Committee that the real budget issue is not the surplus or deficit, but the level of expenditures.

If the Gross National Product is 1000 and the Government takes 200 for its own, 800 is left for the private sector. If the gross product is 1000 and the Government takes 300 for its own, then only 700 is left for the private sector. And this is true whether Government outlays are financed by taxes or by borrowing.

Does it make any difference? The answer is yes, but to a different and lesser extent than popularly supposed. If the Government is financed more by taxes and less by borrowings, interest rates will probably be somewhat lower and there will be more private investment and real economic growth. If the Government is financed more by borrowing and less by taxes, interest rates will probably be higher and there will be less private investment and less real growth.

But the outcome depends also on the tax structure. If taxes bear more heavily on those most likely to save, namely higher income individuals and corporations, interest rates again are likely to be higher and investment less than if taxes fall relatively more on those who are more likely to consume. Thus, the decision on how to finance the Government -- how much borrowing and what kind of taxes -- involves equity between generations as well as within the current generation.

In initially preparing this statement, I anticipated that the question of disinvesting the trust funds would ultimately arise, and I am pleased that the President has advised the Congress that this step will be taken tomorrow if there is no final action on the debt limit by then.

Under present circumstances, such action will meet the highest possible standards of fiscal probity.

It is essential that the Government continue to operate and that there be no default. Moreover, unlike the alternatives, disinvestment of the trust funds need have no ultimately hurtful effects on the beneficiaries of programs financed through these funds.

Whether the assets of the trust funds are represented by debt obligations of the United States or as accounts receivable, these funds are solvent only if the United States is solvent. In the worst of all circumstances, these funds would have no more claim on any moneys in the Treasury than any other legitimate claimant. Default would hurt them and would hurt their beneficiaries.

As to any potential loss of income, the Congress clearly has the power to enact offsetting appropriations and could do so using the same permanent indefinite language used for the appropriation for interest on the public debt.

The Democratic members of the House should, therefore, consider disinvestment of the trust funds to be an idle threat of no substantive significance. Certainly, the prospect should not cause a member to change his position on the Gramm-Rudman-Hollings amendment.

Finally, as I read the Monthly Statement of the Public Debt of the United States for August 31, 1985, the latest which was available to me, there are some $315 billion of Government Account Series obligations outstanding. Disinvestment of these securities would permit sufficient market borrowing to allow the Government to continue operating without further action by the Congress on the debt limit for a period of probably some eighteen months, at which time we will have a new Congress which may be able to deal with the problem.

Thank you.

Chairman LAFALCE. You surely have summarized them.

Mr. Niehenke, in your statement, you quoted a Treasury Department letter in which Acting Secretary Darman indicated that the use of the FFB would be unprecedented and questionable.

What did Treasury mean by the word "questionable"?

Mr. NIEHENKE. We were not concerned about the legality. We thought we were on pretty firm footing there, but we didn't like, and thought inappropriate, the use of the Federal Financing Bank to evade the debt limit process. It is a policy question in our mind. The Secretary engaged the prospect of using the Federal Financing Bank in order to avoid a default in October after the suggestion was made to us that that vehicle might be used. It wasn't until we were confronted with a default that we actually executed a transaction using the FFB's borrowing authority. It is not an action which we took pleasantly. The consequences to us seemed pretty severe.

Chairman LAFALCE. I agree with you that the consequences are severe. I deplore the fact that we had to use the device of the Federal Financing Bank in order to avoid the debt ceiling limitation, but I am wondering if there wasn't a change in policy within the Treasury Department prompted by primarily political considerations.

The sense that I received was that Treasury was adamant against using the Federal Financing Bank until the emergency of Gramm-Rudman surfaced. It seems to me that individuals might have thought they would be able to obtain political mileage out of Gramm-Rudman, which I think is a thousand times more deplorable than the deplorability of using the Federal Financing Bank, and I would think any individual in the Treasury Department in his right mind—and I think everybody in the Treasury Department is in his right mind—would have to agree with me.

It was only then that they said, let's use the Federal Financing Bank. In the meantime, much political mileage has been able to be obtained regarding Gramm-Rudman.

Mr. NIEHENKE. I can just assure you, based upon the process we went through in the Treasury Department, that very early on the Federal Financing Bank was identified as an alternative for us to be used, at which point we researched it legally and came to the conclusion yes, we could do it.

We wanted to resist continued consideration of it, but when we were confronted with a default, we decided to execute a transaction which would use it.

Chairman LAFALCE. The difficulty with all these alternatives is the more you discuss these legal niceties that you can use to avoid the debt ceilings, the more you negate the efficacy of the debt ceiling.

Second, the more you talk about all these alternatives, the less pressure there is going to be on Congress to do anything. Right now, I am interested in how long we could continue to use the resources of the Federal Financing Bank.

I know you used up $5 billion, but how much of the Federal Financing Bank's authority has not been used up? Will you exhaust all of that authority before you go to disinvestment of funds? Which funds would you go to first, and do you agree with Mr.

Snyder who says if you are going to practice disinvestment of funds, you could go along for another 18 months or so without having to do anything about the debt ceiling limitation?

Mr. NIEHENKE. Mr. Chairman, I would report to you that as of the close of business last night, we have used $8.8 billion worth of the Federal Financing Bank borrowing authority, $5 billion of which we have already discussed in testimony.

The balance of the borrowing authority has gone for various debt-consuming operations as I described them. They include State and local government investment series, which we issue, and the Savings Bond Program, which are programs we decided not to shut down because of the complexity and the frustration that that cancellation causes.

With the remaining $6.2 billion of Federal Financing Bank authority, I would represent to you that if we took no other action, that borrowing authority would not get us through the negative cash balance that we are approaching on November 1, and failing other actions.

With regard to the trust fund——

Chairman LAFALCE. Are you saying it wouldn't get us through tomorrow?

Mr. NIEHENKE. Failing other transactions, including the disinvestment of the trust funds. The Treasury, in approaching the negative cash balance tomorrow, announced earlier this week that it would auction securities to the tune of $17.75 billion and that it would settle these securities one of two ways:

Either through debt capacity through action by Congress on the debt limit, or alternatively by disinvestment of certain trust funds in the aggregate of some $17 billion.

The disinvestment of the trust funds is contemplated in the context of the Secretary's charge as the managing trustee for the trust funds. Mr. Snyder referred to the Secretary as being between a rock and the hard place, and I think this is yet another rock and hard place circumstance.

The Secretary of the Treasury as managing trustee has two responsibilities: One, he is obligated to invest the assets of the trust fund. Two, he is obligated to make resources available to make payments to the beneficiaries.

In researching this, we concluded that failure to act on the debt limit to permit financing operations, we would disinvest the trust funds to make those beneficiary payments in November.

Chairman LAFALCE. Do you agree with Mr. Snyder that, deplorable as it might be to disinvest the trust funds to circumvent the debt ceiling limitation, there are approximately $315 billion of Government accounts, series obligations outstanding, and that disinvestment of those securities could permit sufficient market borrowing to allow the Government to continue operating, for a period of probably some 18 months?

Mr. NIEHENKE. We do not share that view. It is our view that the disinvestment of the trust funds is an activity that can only be engaged during that period when beneficiary payments are being presented, the first part of the month.

There is a window of opportunity in the first couple of days of the month to engage the disinvestment transaction, to free up cash to make the payments.

In the second week of the month, for example, when all of those beneficiary payments have been made, it would not be appropriate for the Secretary of the Treasury to do further disinvestment to raise cash to make other payments, so we do not agree with the opinion of Mr. Snyder, that we would continue that operation.

Chairman LAFALCE. I don't want to mislead anybody into thinking that that is a wise policy to follow. I think it would be an atrocious policy to follow, but I am interested in knowing whether or not it would be possible.

In my judgment, this points out the folly of the debt ceiling limitation, but more than anything else, the pure adulterated folly of Gramm-Rudman. Mr. Snyder, would you care to comment?

Mr. SNYDER. I can't speak to what the Treasury might intend to do.

Chairman LAFALCE. He said that you couldn't really do this, you could only use the windows of opportunity at the beginning of the month, and it would be imperative to have a lifting of the debt ceiling, if not at the very beginning of the month, shortly thereafter.

Mr. SNYDER. The Secretary of the Treasury is solely responsible for the investment of certain trust funds. In my judgment, and as I say in my prepared statement, based on comments by Secretary Fowler at the time of a debt limit hearing, when the Secretary is caught between two illegalities and no alternatives which are legal, he becomes a free agent.

On that basis, I think that financial responsibility would call for the Secretary of the Treasury to proceed with the disinvestment of the trust funds.

I am sure that he would do this with total reluctance, but when the ship is sinking, you don't ask whether there is a proper bailing device, you use whatever is available. I am responsible for substantial fixed income investments in my position as a trust officer at the National Bank of Detroit, and I can assure you that the consequences of a default would be enormous.

I am sure that the domestic financial market might recover in relatively short order, but I am also sure that foreign investors who are and have been a major factor in our financial markets for the last several years, in particular, would not recover their confidence in the credit of the United States very rapidly.

So, on those grounds, I do feel that the Secretary, faced with a choice of illegalities, might very well proceed with this, and I think that the lawyers in the Treasury Department would determine that in fact this was a proper course for him to follow.

Chairman LAFALCE. All right.

Ms. Oakar.

Ms. OAKAR. I want to compliment you on this hearing, because I personally think this is one of the most important that I could go to, and I am a conferee, but I think it is possibly as important to ask some questions now, so I want to compliment you on having this hearing, Mr. Chairman.

Mr. Niehenke, in the conference committee, I asked you about the disinvestment of civil service retirement, military retirement,

and Federal supplemental funds, and you did tell me that my information was correct; that is, that those trust funds, that there was a disinvestment since October 1 of some $28 billion——

Mr. NIEHENKE. Failure to invest.

Ms. OAKAR. That is right, because I do want to ask you about Social Security, a different issue, failure to invest, and that those trust funds were losing about $8 million a day, is that correct?

Mr. NIEHENKE. That was the response I gave you, yes.

Ms. OAKAR. Is that money going to be recoupable or not?

Mr. NIEHENKE. Supplemental legislation would be required to recover that for the trust funds.

Ms. OAKAR. Why did the Treasury take the initiative and say tell the American people that you could keep the Government alive for some time by using the mechanism of the Federal Financing Bank, which is unprecedented the way you have used it, but why did you take that initiative?

Did you have any dialog with Senator Gramm about this?

Mr. NIEHENKE. No, to my knowledge, we had no direct dialog with Senators Gramm or Rudman. The issue of the Federal Financing Bank came up very late—well, it came up about mid-September is my recollection, by the Senate staff asking if the Federal Financing Bank could, in fact, be used in order to get by a negative cash balance in October and extend the period of time which they would have to deliberate a debt limit bill.

Chairman LAFALCE. Deliberate a debt limit bill or deliberate Gramm-Rudman?

Mr. NIEHENKE. Debt limit, that was early on. We looked at the legality of that and concluded it was a legal transaction.

Ms. OAKAR. Did you tell them that they would be losing all this money to those trust funds? I don't recall ever seeing that in any information ever put out. Did you tell the Senators that trust fund money would be lost and that it was not recoupable, unless we did a supplemental or something like that?

I mean, yes or no. If you did, you could submit the letter for the record.

Mr. NIEHENKE. We did communicate it specifically.

Ms. OAKAR. Let me ask you—and I know we have a vote on the Journal, and I don't mind missing the vote.

Mr. NIEHENKE. We communicated on numerous occasions that as a result of a lack of investment of those trust funds, that those trust funds would be disadvantaged, and I will provide that documentation for you.

Ms. OAKAR. I would like to have that, because that is very, very important. I want to be very specific in finding out about the Social Security Trust Fund reserves in the last few months, and it is a question that I know you have been asked before, but I am going to ask it for the benefit of this committee, because I think it is important.

[In response to the request of Congresswoman Oakar, the following information was submitted for the record by Mr. Niehenke:]

FOR RELEASE ON DELIVERY
EXPECTED AT 9:00 A.M.
September 10, 1985

STATEMENT OF JOHN J. NIEHENKE
ACTING ASSISTANT SECRETARY OF THE TREASURY
(DOMESTIC FINANCE)
BEFORE THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
OF THE SENATE FINANCE COMMITTEE

Mr. Chairman and Members of the Committee:

My purpose here today is to advise you of the need for Congressional action to increase the public debt limit and to provide additional authority to issue long-term marketable Treasury bonds.

Debt Limit

Our immediate need is for legislation to increase the debt limit.

Our current cash and debt projections indicate that the present debt limit of $1,823.8 billion should be adequate to meet the Treasury's needs until September 30. Without an increase in the debt limit by that date, investment of the Civil Service Retirement and Disability Fund in Treasury securities will have to be delayed to avoid exceeding the debt limit. Then, on October 1, investment of the Military Retirement Fund and, on October 3, the Federal Supplementary Medical Insurance Trust Fund will have to be delayed. Without action on the debt limit, the combined interest losses to these three funds will be about $8 million a day. Also, a delay in debt limit legislation beyond September 30 will require

the Treasury to disrupt its scheduled market borrowings, which could add significantly to the cost of financing the debt.

Our current estimates show the debt subject to limit at $1,840.6 billion on September 30, 1985 and $2,073.4 billion on September 30, 1986, assuming a $20 billion cash balance on those dates. Given these projected debt levels, and allowing a $5 billion margin for contingencies, we request that the debt limit be increased to $1,845.6 billion through September 30, 1985 and $2,078.4 billion through September 30, 1986.

The budget resolution adopted by Congress on August 1 contains debt limit figures of $1,847.8 billion for fiscal year 1985, which is $2.2 billion above our request, and $2,078.7 billion for fiscal year 1986, which is $.3 billion above our request. Thus, the debt figures in the Congressional budget resolution are adequate to meet our estimated needs. These figures are incorporated in H.J. Res. 372, as passed by the House.

Timely action on the debt ceiling is essential to avoid a repetition of past dislocations which have hampered Treasury financing operations. In recent years, delays in action on the debt limit have generated market uncertainty about Treasury financing schedules and on several occasions costly emergency measures have been undertaken, including suspension of savings bond sales, cancellation of scheduled security auctions and failure to invest trust funds.

Finally, prompt action on the debt limit bill is absolutely essential to permit the Government to pay its bills. If the debt limit is not increased, the Government will be unable to meet all of its essential obligations when they fall due -- social security checks, payroll checks, unemployment checks, defense contracts, and principal and interest on its securities.

Long-Term Bonds

Now, I would like to advise you of our need for additional authority to issue marketable Treasury bonds.

The maximum interest rate that the Treasury may pay on marketable bonds (securities with maturities in excess of 10 years) has long been limited by law to 4-1/4 percent. This limit did not become a serious obstacle to Treasury issues of new bonds until the mid-1960's. At that time market rates of interest rose above 4-1/4 percent and the Treasury was precluded from issuing new bonds. The average length of the privately-held marketable debt of the Treasury declined steadily from 5-3/4 years in mid-1965 to about 2-1/2 years in 1975, because of the heavy reliance by the Treasury on short-term bill financing of the budget deficits during this period.

In 1971, Congress authorized the Treasury to issue a limited amount of bonds without regard to the 4-1/4 percent ceiling. The dollar limit since has been increased from time to time, most recently on May 25, 1984, when the limit was raised by $50 billion (from $150 billion to $200 billion) to accommodate additional

long-term financing. Assuming continuation of our recent pattern of long bond issuance, the existing $200 billion authority will be exhausted early in calendar 1986.

Since 1975 the Treasury's debt extension policies have moved the average length of the marketable debt from 2 years, 5 months in January 1976 to 4 years, 10 months in July, 1985, thus broadening the market for Treasury securities and reducing the administrative burden and market-disrupting effects of frequent Treasury operations to refund maturing issues. Yet while the Treasury has significantly improved the maturity structure of the debt in recent years, more than half of outstanding marketable debt matures within two years. This refunding requirement must be added to Treasury's new cash borrowing requirement to meet Treasury's total needs in the market. Because of the short average maturity of outstanding Treasury debt, long bond issuance must remain an integral part of Treasury's debt management policy.

We believe the 4-1/4 percent ceiling should be repealed. This Administration abhors interest rate ceilings as ineffective attempts to control prices and incompatible with our commitment to a free market pricing system. We view the interest rate ceiling on marketable bonds as an anachronism which serves only to frustrate the efficient management of the public debt. Removal of the 4-1/4 percent ceiling on Treasury marketable bonds will help the Treasury meet its financing needs in an efficient, cost-effective manner.

If the interest rate ceiling on long bonds is not abolished, as we believe it should be, we would request an increase in long bond authority of $50 billion, from $200 billion to $250 billion, which would be sufficient to carry us through 1986.

While legislative action on the long bond authority will be necessary to enable us to continue our recent pattern of long bond issuance through 1986, in the interest of expediting action on the debt limit, we would urge the Senate to adopt H.J. Res. 372 without amendment.

That concludes my prepared statement, Mr. Chairman. I will be happy to respond to your questions.

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Ms. OAKAR. Beginning with October 1, was the full advance tax transfer credited to Social Security and invested in securities of indebtedness to finance benefit payments sent out on the third?

Mr. NIEHENKE. It was not. The transfer was made, but it could not be invested, because we were at the debt limit.

Ms. OAKAR. What about on the first of September. Was the entire advanced tax transfer amount invested in short-term certificates of indebtedness?

Mr. NIEHENKE. There was a shortfall of investment by about $2 billion, which occurred right at the end of the month, which is when we came up against the debt limit.

Ms. OAKAR. Did you draw down specifically, especially Government bonds to make up the difference, specially issued Government bonds?

Mr. NIEHENKE. Lack of investment?

Ms. OAKAR. Right.

Mr. NIEHENKE. Did we draw down specific Government obligations to make up the difference?

Ms. OAKAR. Right.

Mr. NIEHENKE. If I think I understand the question, the answer is no.

Ms. OAKAR. You answered yes yesterday.

Mr. NIEHENKE. That was a different question.

Ms. OAKAR. These are very similar questions that you were asked yesterday.

Mr. NIEHENKE. In the month of October, which is clearer because it is a month that can be isolated and understood, the first part of the month——

Ms. OAKAR. No, let me tell you something. Mr. Chairman, this is the whole point of my questioning, and I have a series of other questions which I would like to submit for the record to this witness.

Chairman LAFALCE. You may submit them for the record, but you may also continue beyond the 5-minute time period.

Ms. OAKAR. The point of this series of questions is this, and this is why older Americans and people who depend on that trust fund, employers who have invested in it, have such little confidence.

The perception is out there that somebody manipulates their money and then they say there is a shortfall, and so on. The point is that if there has been a disinvestment not since October 1, or what we are being told, we are being held to the gun today saying that tomorrow—and I saw Mr. Miller on television today indicating that tomorrow, we are going to dip into the trust funds, or not invest them, so on.

The truth of it is, that is baloney. You have been manipulating this trust fund since August 1 without telling the American people, and that trust fund has lost millions and millions of dollars since then. I want to ask the series of questions, Mr. Chairman, but that is the simple bottom line answer.

Chairman LAFALCE. I think we should afford Mr. Niehenke an opportunity to respond to that charge.

Mr. NIEHENKE. I would respond at this time, and we will have to get into detail, the operation of that trust fund has been no differ-

ent than any other trust fund, and handled in a way which we find very appropriate in the normal course of operating a trust fund.

The one you referred to is the normalized transfer, Social Security, and is unique in the way it operates, the way a transfer occurs at the beginning of the month, in the way the investment is made for that trust fund, which is ahead of tax receipts actually being received.

It is the only trust fund that operates that way.

Ms. OAKAR. Have you been complying with statutory requirements?

Mr. NIEHENKE. To my knowledge, yes.

Ms. OAKAR. Why does Secretary Baker tell us, in a letter of October 1 to Senator Dole, "We have been unable to comply with statutory requirements to fully invest several trust funds."

Mr. NIEHENKE. To the extent we have been able to, we have complied with statutory requirements. We don't have debt capacity to meet all these obligations.

Ms. OAKAR. You had debt capacity in August. You had debt capacity in September, and the Secretary of Treasury, I believe, I honestly believe this, has been working in some kind of framework with the Senate, and that is understandable at times, to make the American people think that we are at fault for the disinvestment or noninvestment, depending on what month you are talking about, of these funds when, in fact, you have been violating the law since at least, as far as we can trace, August 1.

I think that is incredible, that you would manipulate those trust funds like that, and Mr. Chairman, it has nothing to do with Gramm-Rudman.

I really feel that there are some real problems out there that go beyond the scrutiny of a GAO. I know you asked for a GAO report on whether or not the Bank was being used properly, but Mr. Chairman, it goes far beyond that.

The question beyond that, Mr. Chairman, is have these trust funds been invested properly or noninvested or disinvested, as the case might be, and it is far beyond the November 1 deadline.

Mr. NIEHENKE. We would deny that there is any impropriety in our management of these trust funds. We have been frustrated by the fact that we cannot meet our trustee obligations because of a failure to have action on the debt limit, and therefore, the debt capacity to execute those tasks, but I would say with regard to the redemptions occurring in the trust funds during the September-October period, they are standard procedure applying to all trust funds. They were not disinvestments as we are describing them for the early November period.

Chairman LAFALCE. I think it might be helpful if you distinguished between a redemption and a disinvestment. Then we will have to go on to Mr. Cooper.

Mr. NIEHENKE. Let me describe for you how a typical trust fund operates. The typical trust fund receives revenues at whatever time during the month. When those revenues are received in the fund, they are automatically invested in some Treasury obligations, depending upon how that particular fund is structured. As payments are presented to the fund by the beneficiaries, redemptions are

made, and those interest-bearing obligations are then redeemed, so that is the redemption in the normal course of things.

Disinvestment as envisioned for November 1 involves the acceleration of that redemption process whereby, rather than wait for the payments to actually be received in a timely manner over a 4 or 5-day period, we would redeem on an accelerated basis, cancel the debt in order to create debt capacity, to go to the market, raise cash and meet those beneficiary payments. So redemption in the normal course of things means that as payments come into the fund, then the Government securities are redeemed at that time.

By the disinvestment, we mean the accelerated redemption of those obligations within a particular fund.

Chairman LAFALCE. What you are saying is that during the period in question, August or so, you were engaged in appropriate, timely redemptions, but not accelerated redemptions or disinvestment, is that correct?

Mr. NIEHENKE. That is correct.

Chairman LAFALCE. Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman.

I apologize for stepping out for a minute there for that important Journal vote. I am interested in hearing the witnesses quantify, if possible, the harm, if any, to folks in this country by using the Federal Financing Bank mechanism, and, second, by the disinvestment or accelerated redemption should any occur after tomorrow.

First, regarding the Federal Financing Bank, Mr. Niehenke, I didn't understand your testimony thoroughly, but it is my impression, in fact, you indicated regarding the 1985 sale, that FFB borrowings carry a substantially higher interest rate.

Have you all calculated the interest premium that we had to pay?

Mr. NIEHENKE. When the suggestion was originally made that we use the FFB to bridge a transitory period to avoid a default, we contemplated how to execute that most efficiently. Our experience, as you point out, had been that the last time we went to the market with the Federal Financing Bank obligation, the market demanded a premium for that, and the reason was it was a new instrument, it hadn't established liquidity yet, and it wouldn't be expected to trade on the same par with a Treasury security in the marketplace.

Recalling that circumstance and contemplating how the FFB could be used, we devised a transaction whereby the Federal Financing Bank borrowing authority would be used to substitute for a Treasury obligation currently outstanding in one of the trust funds, and that obligation would be redeemed and that redemption would create debt capacity, to permit us to go the market. In October, we went to the market with Treasury obligations and borrowed at what was then the Treasury rate.

Mr. COOPER. The civil service retirement swap? There was no cost whatsoever to the Treasury for this unusual financing mechanism?

Mr. NIEHENKE. No cost to the trust fund and Treasury borrowed at market comparable rates, so I cannot define any premium that was paid or any extraordinary costs associated with that transaction.

I would say that is a neutral transaction.

Mr. COOPER. You will defend me and other members, should we have a tax next year for the increased costs for the month of October, that may have ended up costing the taxpayer?

Mr. NIEHENKE. I will be by your side.

Mr. COOPER. What prevents us from being attacked by Social Security recipients for dipping into their trust assets?

Mr. NIEHENKE. The best answer to that is what is the alternative, and the alternative is not paying those Social Security beneficiaries in early November. What the Secretary is confronted with is a conflict in his responsibilities as a trustee here. On the one hand, he has the obligation to invest trust fund assets. On the other hand, he has the obligation to make assets available for beneficiary payments.

By the disinvestment transactions, we are trying to meet beneficiary payments in early November and therefore, we propose to accelerate disinvestment of the trust funds, to meet those obligations, so I think that the bottom line of that is that November beneficiary payments are going to be met as opposed to a circumstance where we would default and they wouldn't be met.

Mr. COOPER. That is the lesser of two evils, but I would like to know how much the disinvestment evil would end up costing Social Security beneficiaries? Is there any way to measure how much evil will be transpiring?

Mr. NIEHENKE. Well, if we engage the transaction of disinvesting, $17 billion worth of trust fund assets on November 1.

Mr. COOPER. $17 million?

Mr. NIEHENKE. $17 billion on November 1. We estimate the cost to be roughly $10 million to those funds.

Mr. COOPER. So that—is there any mechanism for making up that cost to the trust fund so we would not be accused of injuring the Social Security Trust Fund to the extent of $10 million?

Mr. NIEHENKE. It is my understanding that some supplemental legislation would have to be proposed in order to rectify the trust fund circumstances.

Mr. COOPER. To appropriate the money and turn it over to the Treasury?

Mr. NIEHENKE. That is right. We would not be opposed to that.

Mr. COOPER. Over the weekend, you would borrow the $17 billion or disinvest the $17 billion, and a weekend expense would be $10 million?

Mr. NIEHENKE. What is involved is an analysis of how much we are accelerating those redemptions. In other words, how quickly are we accelerating the redemption process, thereby leaving those assets uninvested?

The answer to that question is normally, redemptions would be made over a 4- or 5-day period in the beginning of the month, and we are accelerating that to the first day of the month, losing $17 billion for 4 or 5 days, and that calculation works out to be something like $10 million.

Mr. COOPER. You wouldn't view disinvestment as being possible after that 5-day period, whereas Mr. Snyder would claim that we have so many of these trust assets we could disinvest for the next 18 months and still keep us going?

Mr. NIEHENKE. Our opinion is going back to these two conflicts, if the Secretary decides he is going to make assets available to meet beneficiary payments, the time frame in which he can do that should be limited to that period of time in which the beneficiary payments are made. That occurs at the beginning of the month, takes approximately 5 days, and by making the $17 billion available on November 1, it is our view that we will have fulfilled an obligation on a best-efforts basis to make those payments available. Therefore, if we address the next date, as to when we next run out of cash, that date is November 15, and it is our opinion, if we look upon the trust fund disinvestment option at that point, it would not be available to us because we can't make the same claim that we are making that available to make the beneficiary payments.

Our claims on November 15 don't have to do with beneficiary payments primarily. They have to do with payment of $16 billion worth of interest and principal due on the national debt.

We cannot conclude that we could disinvest the trust funds for that same purpose, because that is clearly not the case.

Chairman LAFALCE. Which raises the interesting question which has not been addressed as to the legal authority to engage in disinvestment, under what circumstances and for what purposes?

We have addressed the legal authority to use the Federal Financing Bank. Mr. Havens has addressed that, but would anybody care to give me the legal justification for using these trust funds?

Mr. NIEHENKE. As I have articulated——

Chairman LAFALCE. Mr. Havens?

Mr. HAVENS. We have not researched the legal issues related to disinvestment of the trust fund. We would be happy to do so, if you would like us to do that.

[The letter to the Hon. James R. Jones, chairman of the Subcommittee on Social Security of the House Committee on Ways and Means and appendices of the Comptroller General of the United States was subsequently received for inclusion in the record:]

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

December 5, 1985

B-221077

The Honorable James R. Jones, Chairman
Subcommittee on Social Security
Committee on Ways and Means
House of Representatives

Dear Mr. Chairman:

Subject: Treasury's Management of Social Security Trust Funds During the Debt Ceiling Crises (GAO/HRD-86-45)

In your November 1, 1985, letter, you asked for our opinion on the legality and propriety of the Secretary of the Treasury's management of the Social Security Trust Funds (Federal Old Age and Survivors' Insurance Trust Fund and Federal Disability Insurance Trust Fund) during the government's October 1984 and September-November 1985 public debt ceiling crises. You also asked for factual information on the Department of the Treasury's actions regarding the Trust Funds and the effects of those actions on the Funds' long-term investments.

Appendix I addresses the legal issues raised in your letter. We conclude that, although some of the Secretary's actions appear in retrospect to have been in violation of the requirements of the Social Security Act, we cannot say that the Secretary acted unreasonably given the extraordinary situation in which he was operating. On the other issues you raised, we conclude that:

--Treasury may restore any interest lost because of failure to fully invest the normalized tax transfers.

--To the extent that the Trust Funds' assets were kept uninvested to permit the payment of other obligations of the government or to restore cash balances, the Trust Funds were being used to sustain the government's operations contrary to the statutory scheme.

--Because the Trust Funds transactions did not increase the total amount of outstanding debt subject to the statutory limit, the Secretary did not violate the statutory debt limit and did not usurp the congressional power under the Constitution to borrow.

--There is no evidence that the Secretary redeemed securities, or failed to invest funds, for the purpose of avoiding General Fund interest payments to the Trust Funds, which would be contrary to his statutory duty as Managing Trustee.

Appendix II presents the factual information on Treasury's actions in not timely investing and in disinvesting Social Security Trust Funds' assets during the 1984 and 1985 debt ceiling crises.

In reviewing Treasury's recent actions, we found that normalized tax transfer (NTT) amounts were not fully invested in interest-bearing Treasury securities at the beginning of September, October, and November 1985. Instead, Treasury redeemed the Trust Funds' short- and long-term securities to meet social security benefit payments. Our analysis shows that, if adequate borrowing authority under the statutory limit had been available during September through November 13, it would not have been necessary to redeem any of the Trust Funds' long-term securities. We also found that the noninvestment of NTT amounts in September and October was not unprecedented--similar actions were taken in 1983 and 1984. However, the actions of November 1985 appear to have no precedent.

As agreed with your office, neither the Treasury Department nor other administration officials have been given an opportunity to formally review and comment on this report. However, the legal issues and factual information presented in this report were discussed with Treasury officials during our examination.

After your November 1 letter, your office asked that we also examine the Treasury Department's management of the Railroad Retirement Trust Funds during the 1985 debt ceiling crisis. As agreed with your office, this information will be provided in a separate report.

Unless you publicly announce the contents of this report earlier, we will withhold further distribution of it for 2 days, after which copies will be made available to other interested congressional committees and members; the Secretary of the Treasury; the Director, Office of Management and Budget; and other interested parties.

Sincerely yours,

Charles A. Bowsher

Comptroller General
of the United States

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ABBREVIATIONS

CI	certificate of indebtedness
DI	Disability Insurance
NTT	normalized tax transfer
OASDI	Old Age, Survivors', and Disability Insurance
OASI	Old Age and Survivors' Insurance

LEGALITY OF SECRETARY OF THE TREASURY'S MANAGEMENT OF SOCIAL SECURITY TRUST FUNDS DURING THE 1985 DEBT CEILING CRISIS

This appendix addresses the legality of the Secretary of the Treasury's management of the Social Security Trust Funds[1] during the government's debt ceiling crisis this year. For the reasons indicated below, we conclude that, although some of the Secretary's actions appear in retrospect to have been in violation of the requirements of the Social Security Act, we cannot say the Secretary acted unreasonably given the extraordinary situation in which he was operating.

BACKGROUND

It must be understood that there are no Social Security Trust Funds in the sense that the term is normally used in the private sector. That is, there is no body of assets, derived from social security tax revenues, which is separately held and managed for the benefit of participants in the social security system. Instead, there are only accounts maintained on the books of the Treasury called Social Security Trust Funds.

In a normal month, on the first business day of the month, the Secretary of the Treasury, under subsection 201(a) of the Social Security Act, as amended, 42 U.S.C. § 401(a), transfers from the General Fund and credits to the Social Security Trust Funds an amount equivalent to the estimated payroll tax revenues which will be received that month. These funds, called the normalized tax transfer, are immediately invested in short-term Treasury securities. Social security benefits for the month are paid from the General Fund of the Treasury. On the benefit payment date, which is usually the third day of the month, a portion of the Treasury securities held by the Trust Funds are redeemed to reimburse the General Fund for social security benefits which are paid by electronic fund transfer on that date. Additional securities are redeemed 4 and 5 business days later to reimburse the General Fund for social security benefits which were paid by check on the benefit payment date. Actual payroll tax revenues during the month are deposited directly in the General Fund of the

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[1]In this opinion we shall refer to the Federal Old Age and Survivors' Insurance Trust Fund and the Federal Disability Insurance Trust Fund as the Social Security Trust Funds.

Treasury in order to keep it whole for the normalized tax transfer to the Trust Funds.

In months in which the normalized tax transfer is greater than the amount of social security benefits, the surplus remains invested in Treasury securities. Each June 30, any surplus for the year, after correcting for actual payroll taxes received, is converted to investment in long-term securities. In months in which the normalized tax transfer is less than the amount of social security benefits, the Secretary must redeem not only the securities purchased with that month's normalized tax transfer but also other short-term securities sold to the Trust Funds during the year to cover the excess payments. If there are insufficient short-term securities maturing the following June 30, he is forced to redeem long-term securities representing surpluses of prior years.

The Events of September, October, and November

In September, October, and November 1985, there were some departures from the normal procedure. On September 3, the first business day of the month, the Secretary effected the normalized tax transfer by crediting the estimated payroll tax revenues for the month to the Trust Funds. However, because the Treasury Department was near the debt ceiling, the Secretary invested only a small amount of the transfer. Instead, the bulk of the credit representing the transfer was kept in a non-interest-bearing account. September 3 was also the September benefit payment date. To reimburse the General Fund of the Treasury for the electronic fund transfers that took place that day, the Secretary redeemed current-year securities, and, because these were insufficient to cover the full amount of the payments, some long-term securities held by the Trust Funds as well. Four and five business days later, to reimburse the General Fund for benefits paid by check, the Secretary redeemed additional long-term securities of the Trust Funds. During the month, as total Treasury borrowing fell below the debt ceiling, the Secretary invested most of the uninvested normalized tax transfer funds in short-term securities.

On October 1, the Secretary again made the normalized tax transfer by crediting the anticipated payroll tax revenues to the Trust Funds. He did not immediately invest the transferred credits because total Treasury borrowing was already at the debt limit. He redeemed securities held by the Trust Funds on October 3, the electronic fund transfer benefi:

payment date, and, on the fourth and fifth business days after that date for check payments, to reimburse the General Fund for October social security benefits. Unlike September, however, the Secretary did not invest any of the uninvested normalized tax transfer funds later in the month because total Treasury borrowing did not drop below the debt limit.

On November 1, the Secretary again made the normalized tax transfer. As in September and October, the funds were credited to a non-interest-bearing account rather than being invested because Treasury borrowing was at the debt ceiling. November 1 was also the electronic fund transfer benefit payment date. Benefit checks were dated November 2. The Treasury Department estimated that it would have insufficient cash on November 1 to pay social security benefits and other government obligations. In order for these payments to be made, the Treasury needed to borrow money from the public, and in order to borrow the money, Treasury had to reduce its outstanding debt below the statutory limit. Therefore, on November 1 the Secretary redeemed $9.613 billion of the Trust Funds' long-term securities, and $1.9 billion of securities held by certain other government-managed trust funds, to permit public borrowing of about $11 billion. On November 4, an additional $4.161 billion of the Trust Funds' securities were redeemed, as well as securities held by the other trust funds, which allowed public borrowing of $4.75 billion. Finally, on November 8 and 12 an additional $715 million and $266 million, respectively, of the Trust Funds' obligations were redeemed.

On November 14, when the Congress passed a temporary increase to the statutory debt limit, the Secretary was able to invest the Trust Funds' uninvested assets.

DISCUSSION

The Secretary of the Treasury was subject to two statutory obligations and a statutory constraint relevant to his management of the Social Security Trust Funds during September, October, and November of this year.

First, subsection 201(a) of the Social Security Act, as amended, 42 U.S.C. § 401(a), provides that the monthly normalized tax transfer "shall be invested by the Managing Trustee in the same manner and to the same extent as the other assets of the Trust Funds." Subsection 201(d), 42 U.S.C. § 401(d), requires the Secretary of the Treasury, as Managing Trustee of the Trust Funds, "to invest such portion of the Trust Funds as

is not, in his judgment, required to meet current withdrawals." The investments may be made only in interest-bearing obligations of the United States or obligations guaranteed by the United States.

Second, the Secretary has a statutory duty to pay social security benefits to those who are entitled to receive them. See title II of the Social Security Act, as amended, 42 U.S.C. §§ 401-433.

The constraint lies against the Secretary's authority to borrow money on the credit of the United States. The Constitution grants the power to borrow money to the Congress. U.S. Const., art. I, § 8, cl. 2. While the Congress has, by statute, authorized the Secretary to borrow money on the credit of the United States, it has limited the authority for most borrowing by a debt ceiling. During September, October, and the relevant period of November of this year, that limit was $1,823,800,000,000. See 31 U.S.C. § 3101(b). Investment of the Social Security Trust Funds' assets count against this limit. Section 201(d), supra.

There is no inherent conflict between these statutory obligations. As long as there are adequate funds in the cash account through which the government conducts all cash transactions, both obligations can be met. Funds in the account can be used to pay social security benefits and, if necessary, to reduce the government debt held by the public so that the Trust Funds' assets can be invested without exceeding the debt ceiling. On the other hand, if there are not sufficient funds in the cash account, then both obligations cannot be fully met, and the Secretary is forced to choose the manner in which he will satisfy them.

An examination of the data shows that, although there were insufficient funds in the Treasury cash account in September, October, and November for the Secretary to fully satisfy both obligations, he could have done more than he did to invest the Trust Funds' assets while assuring that all benefit payments were made.

For example, on September 3, Treasury had a sufficient operating balance in its cash account and available borrowing authority under the debt limit to permit the Secretary to pay social security benefits that day and still invest substantially more of the normalized tax transfer than he did. Further, it appears that the Secretary could have continued to meet the government's obligations throughout the month and still have kept a larger proportion of the Trust Funds' assets

invested for a longer period than he did. By the end of the month it should have been possible to have invested the entire normalized tax transfer amount.

Further, given the actual events of September, the Secretary could have kept a larger amount of the Trust Funds' assets invested for a longer period in October than he did and still have paid benefits. Admittedly, by October 1, the Treasury was already at the debt ceiling. There was a sufficient operating balance in its cash account, however, to permit the Secretary to redeem outstanding publicly held securities, thus permitting investment of some of the normalized tax transfer. Although these investments soon would have had to be redeemed to cover benefit payments, in our opinion the Secretary did not keep the Trust Funds' assets invested for as long a time and in as large amount as he could have.

The November situation was more complex. On November 1, there was no available borrowing authority, and Treasury's cash balance was insufficient for the Secretary either to pay benefits or to invest any part of the normalized tax transfer. The Secretary, therefore, could not meet both of his statutory obligations within the constraint imposed. He elected to pay the social security benefits. To do this, he needed first to ignore his obligation to invest the normalized tax transfer, which he did. Second, he needed to redeem approximately $5 billion of the Trust Funds' existing investments in order to borrow enough money to bring the balance in the cash account to approximately $6.9 billion, the amount needed to make the benefit payments. In fact, however, the Secretary redeemed $9.6 billion of the Trust Funds' investments on November 1, more than appeared to be necessary on that day.

During the period of November 4 to 12, the Secretary redeemed additional Trust Funds' investments in order to borrow additional funds to cover November benefits paid by check. The total redemptions during November 1 to 12 were about the same as the total benefits paid. However, it appears that the redemptions occurred at a faster rate than necessary to make the benefit payments.

In sum, it appears, on the basis of the information now available, that the Secretary redeemed or failed to invest the Trust Funds' assets in amounts and for periods of time greater than absolutely necessary to pay social security benefits. However, this is a judgment reached only with the benefit of hindsight. The Secretary was required to act in a complex and

fluid situation, without the benefit of all of the information now available.[2] Further, the Secretary had many other duties to carry out, including managing the government's finances and investing assets of and making payments from other government-managed trust funds. Under all the circumstances involved, we conclude that he did not act unreasonably.

OTHER QUESTIONS ADDRESSED

Other questions raised by Treasury's actions are discussed below.

Question 1: Does Treasury have authority to restore interest that may have been lost because the Secretary did not invest the entire normalized tax transfers in September, October, and November?

Aside from providing for the normalized tax transfer, subsection 201(a) of the Social Security Act, 42 U.S.C. § 401(a), provides that the Trust Funds shall pay to the General Fund the difference between the interest they earn from the invested normalized tax transfer and the interest they would have earned if they had invested payroll tax revenues as they were received during the month.

Interest earned on the Trust Funds' investments is credited to the Trust Funds every 6 months, in June and December. At the same time, the Trust Funds pay to the General Fund the interest required by subsection 201(a). In December 1985, Treasury should be able to restore interest lost due to noninvestment of the normalized tax transfers in September, October, and November, by offsetting that amount against the interest the Trust Funds owe to Treasury under subsection 201(a) for the months in which the transfer was invested.

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[2]Because of the complexity of Treasury operations, the Secretary is unable to know at any given time the exact operating balance in the cash account or the exact amount of debt. Much of the information he has is based on estimates. To provide a safety margin against inadvertent statutory violations, it is Treasury policy to try to maintain a minimum cash balance and to leave a small amount of debt unused. We find these procedures to be reasonable.

Question 2: Did the continued deposit of payroll tax revenues in the General Fund, the failure to make the normalized tax transfer in advance each month, and the subsequent cancellation of long-term bonds, together result in the Trust Funds being used to finance general government expenses in violation of the intent and requirements of the Social Security Act?

The normalized tax transfer procedure established by subsection 201(a) of the Social Security Act, as amended, contemplates a transfer to the Trust Funds, in advance at the beginning of the month, of the estimated amount of the payroll tax revenues which are expected to be received that month. The actual payroll taxes are deposited as they are received in the General Fund of the Treasury rather than in the Trust Funds because the Trust Funds have already been credited with that revenue. As indicated above, the normalized tax transfers for September, October, and November were made by the Secretary. However, he did not fully invest them. Therefore, there was nothing improper in payroll tax revenues being used to meet general obligations of the government.

However, not all of the withholding from investment and securities redemptions in September, October, and November were necessary to meet social security benefit payments. To the extent that the Trust Funds' assets were kept uninvested to permit the payment of other government obligations or to restore cash balances, the Trust Funds were being used contrary to the statutory scheme to sustain the government's general operations.

Question 3: By not investing the normalized tax transfer and by redeeming long-term obligations to finance social security benefits, did the Secretary, in effect, raise the debt ceiling without an act of Congress? Does the executive branch have the constitutional and statutory authority to act this way?

Article I, section 8, clause 2, of the Constitution authorizes the Congress "To borrow Money on the credit of the United States." The Congress has delegated this authority to the Secretary of the Treasury in chapter 31 of title 31, United States Code, subject to the limitation in 31 U.S.C. § 3101(b). The debt subject to the limit is defined as "[t]he face amount of obligations issued under [chapter 31 of title 31] and the face amount of obligations whose principal and interest are guaranteed by the United States Government * * *. " Id. Subsection 201(d) of the Social Security Act provides that securities issued to the Trust Funds are issued under chapter 31 of title 31, and therefore, they are counted toward the debt limit.

There are two ways of looking at the Secretary's failure to invest the normalized tax transfer and his redemption of long-term obligations. Debt subject to the statutory limit consists of securities held by the public and securities held by government agencies, including the Trust Funds. The Trust Funds' transactions in September, October, and November had the effect of reducing the portion of the debt held by government agencies and increasing the portion held by the public. However, they did not increase the total amount of outstanding debt subject to the statutory limit. Therefore, it may be said that the Secretary did not violate the statutory debt limit and did not usurp the congressional power under the Constitution to borrow. Under this view the measure of debt subject to the debt limit is determined solely by the amount of applicable securities outstanding.

A distinction must be recognized, however, between timely actions by the Secretary regarding amounts up to the total of social security benefits paid and those of his actions regarding amounts which exceeded requirements to meet social security benefit payments. Timely disinvestment or failure to invest (that is, such actions taken in proper amounts to finance imminent social security payments due) were authorized and proper, as the Trust Funds are not entitled to interest earnings on the amounts involved. On the other hand, excessive amounts disinvested or not invested (that is, amounts over and above those needed to meet social security payments) may be viewed as having given rise to exceeding the debt ceiling where the excess amounts when added to the debt ceiling securities outstanding totaled more than the authorized ceiling.

Conceptually, the second analysis is more satisfying--excessive amounts disinvested or not invested should be added to the government's outstanding debt, as if those amounts were, in fact, a debt to the Trust Funds. Yet, given the necessity for Treasury's operations to be on the basis of estimates and in light of the grave consequences attendant to the government defaulting on its obligations, it does not appear that the Secretary can reasonably be said to have acted improperly in September, October, and November, despite the facts as we now know them to have been.

Question 4: Has the Secretary breached his duty as fiduciary by sacrificing the interests of the Trust Funds for the purpose of minimizing general revenue interest obligations to the Trust Funds?

First, we note that by statute neither the Secretary nor any of the other trustees of the Trust Funds are fiduciaries. 42 U.S.C. § 401(c). Rather, the duties of the Secretary as Managing Trustee are set by the Social Security Act.

Moreover, there is no evidence that the Secretary redeemed securities, or failed to invest funds, for the purpose of avoiding General Fund interest payments to the Trust Funds.

FACTUAL INFORMATION ON TREASURY'S MANAGEMENT OF SOCIAL SECURITY TRUST FUNDS DURING THE 1984 AND 1985 DEBT CEILING CRISES

INTRODUCTION

On November 1, 1985, the Chairman, House Ways and Means Subcommittee on Social Security, requested that we investigate the Department of the Treasury's handling of the Social Security Trust Funds--Federal Old Age and Survivors' Insurance (OASI) Trust Fund and Federal Disability Insurance (DI) Trust Fund--during the past several months and in October 1984. Many of the issues raised were of a legal nature regarding the Funds' investment and disinvestment; our legal opinion on those issues is contained in appendix I. This appendix discusses factual information on the Department's actions in the context of the statutory debt limit. Specifically, the Chairman asked us to determine:

--What actions Treasury took with respect to the Social Security Trust Funds in October 1984 and in August, September, October, and November 1985.

--How much of estimated monthly tax receipts were invested in interest-bearing securities held by the Trust Funds on the first day of each of these months to finance benefits.

--What long-term bonds were redeemed in each of these months to finance benefit payments and whether these bonds would have been otherwise redeemed had there been no possibility of the federal government reaching the debt limit in any of those months.

--Whether the Treasury has routinely drawn upon long-term reserves of the Trust Funds to generate additional borrowing authority and thus avoid hitting the debt ceiling.

RESULTS IN BRIEF

In summary, we found that:

--During September, October, and the first 13 days of November 1985, Treasury did not invest $28.2 billion in accumulated normalized tax transfers credited to the

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Trust Funds at the beginning of those months, due to the statutory debt ceiling having been reached on September 3, 1985. With the $80 billion temporary increase in the debt ceiling enacted on November 14, 1985, Treasury immediately acted to invest all of the $28.2 billion, initially, in short-term interest-bearing certificates of indebtedness maturing on June 30, 1986. However, as required by the temporary debt ceiling legislation, Treasury subsequently reinstated $18,512 million of this amount in long-term bonds carrying their original interest rates and maturity dates.

--During the same September-November 1985 period, Treasury redeemed $27.9 billion in long-term, special-issue bonds bearing interest rates ranging from 8-3/4 to 10-3/4 percent, with June 30 maturity dates ranging from 1986 to 2000. The Trust Funds' highest interest-bearing long-term securities, at 13-3/4 percent and totaling $5.2 billion, were not redeemed. The resulting borrowing authority below the debt ceiling gained by these redemptions was used to generate operating cash in Treasury's General Fund to continue government operations, including paying social security benefits.

--In the absence of a limit on Treasury's borrowing authority, none of the long-term bonds would have had to be redeemed as Treasury would have been able to follow its normal Trust Fund investment/redemption practices throughout September, October, and November 1985.

--During September and October 1984, Treasury redeemed high-interest-bearing, long-term, special-issue Treasury bonds held by the Trust Funds to obtain borrowing authority under the statutory debt ceiling so that social security benefit payments could be made.

--Treasury's actions in September and October 1985--redeeming long-term securities held by the Trust Funds to generate borrowing authority under the debt limit--were similar to those in past debt ceiling crises. However, the accelerated redemption of securities in November 1985 appears unprecedented.

SCOPE AND METHODOLOGY

In conducting our review within the time frame provided in the Chairman's letter, we concentrated primarily on Treasury's

actions during August through November 15, 1985. We met with Treasury officials in the Office of the Assistant General Counsel for Banking and Finance, Office of the Fiscal Assistant Secretary, and Financial Management Service, to obtain specific data and documentation, and we reviewed Trust Fund investment ledgers. We also reviewed recent Treasury testimony and other information contributed for the public record concerning Treasury's procedures and actions. Our findings represent a distillation of the information obtained directly from Treasury and additional information provided by other sources.

TREASURY'S NORMAL TRUST FUND INVESTMENT PRACTICES

Treasury's practice regarding the Social Security (OASI and DI) Trust Funds on June 30 of each investment year (July 1 to June 30) is to convert any year-end surplus funds into long-term, special-issue, nonmarketable Treasury bonds with varying maturities of 1 to 15 years. These surplus funds are generally held during the year in short-term securities called certificates of indebtedness (CIs) having a maturity date of June 30. Therefore, all of the assets of the Trust Funds as of June 30 are invested in Treasury bonds.

As table II.1 shows, the total assets of the Trust Funds as of July 1, 1985, were $36,883 million, all of which were in long-term, special-issue bonds.

At the beginning of each month, based on procedures adopted in the 1983 Amendments to the Social Security Act, the Treasury Department advances to the Trust Fund receipt accounts an amount equal to the estimated Social Security payroll tax (FICA and SECA)[1] receipts for that month. This amount, called a normalized tax transfer (NTT), is an advance that normally is immediately invested in CIs. The interest earned on this advance must be repaid to the Treasury, and the actual (net) interest earned by the Trust Funds is that which would be earned by investing actual tax receipts as received during the month.

NORMAL PRACTICES FOLLOWED IN JULY AND AUGUST 1985

On July 1, 1985, an NTT amount of $13,785 million was credited to the Trust Funds and immediately invested in CIs.

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[1]Federal Insurance Contributions Act and Self-Employment Contributions Act.

These and other certificates were redeemed during the month to meet required disbursements for benefit payments and expenses. During July the short-term certificates as well as some 10-3/8-percent special-issue Treasury bonds, all with maturity dates of June 30, 1986, were redeemed to finance disbursements. In this case about $638 million in bonds were redeemed in addition to CIs; however, this was not unusual because bonds and CIs maturing on the same date are treated identically for redemption purposes. Treasury would normally redeem the lowest interest rate first for these "short-term" issues.[2] Treasury's actions during July left securities balances as of July 31 of $1,564 million in CIs and $36,244 million in bonds (see table II.1).

In August 1985 the normalized tax transfer was credited to the Trust Funds in the normal way and amounted to $13,968 million. This amount was fully invested in CIs. During the month $14,680 million in CIs and $1,808 million in 10-3/8-percent bonds maturing on June 30, 1986, were redeemed to pay benefits and expenses. Thus, in terms of Trust Fund investment/redemption procedures, August, like July, could be considered a normal month. At the end of August the total assets of the Trust Funds were $37,355 million; $37,196 million of this total was invested. Special-issue bonds totaled $34,436 million. (See table II.1.)

TREASURY DEPARTED FROM NORMAL PRACTICES IN SEPTEMBER AND OCTOBER 1985

At the beginning of September, the Treasury General Fund held an operating cash balance of $11,841 million, and the public debt subject to the statutory limit was within $5,113 million of the debt limit. Therefore, on the first business day, September 3, Treasury credited the Trust Funds with the NTT ($15,128 million); however, most of this amount was not immediately invested because of the statutory debt limit (see table II.2). By the end of the first business day in September, the public debt was within $5 million of the debt limit.

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[2]That is, all Trust Fund securities maturing on June 30, 1986, regardless of whether they are CIs or bonds are considered "short-term" securities as this term is used in appendix I. Whereas all bonds could be considered long-term, in appendix I "long-term" refers to all bonds held by the Trust Funds except those maturing at the end of the current investment year (i.e., June 30, 1986).

Treasury met benefit payments from the General Fund, and this was followed by redemption of available CIs and bonds. In this case, Treasury redeemed long-term bonds--specifically, 10-3/8-percent bonds maturing in 1987-88 in an amount of $6,901 million on September 3, 9, 19, and 30 (see tables II.6 and II.7). If Treasury had sufficient borrowing authority below the debt ceiling to fully invest the September NTT at the beginning of the month, long-term bonds would not have had to be redeemed in September. During September total redemptions of Trust Funds securities were $16,110 million. This amount was $4,447 million less than the total CIs that would have been available to cover these redemptions, had Treasury been able to follow its normal NTT investment procedures (see table II.3).

As borrowing authority became available under the debt limit during September, Treasury moved to invest the NTT amount, and by the end of September, most of the NTT amount was so invested. Available CIs at the end of September totaled $8,875 million. The uninvested NTT amount was $2,348 million. Trust Funds investments totaled $36,410 million. (See tables II.1 and II.4.)

On October 1, 1985, the Treasury General Fund held a beginning operating cash balance of $17,060 million, and the public debt subject to the statutory limit was still within $5 million of the debt limit. Because October 1 was the first business day of the month, $12,783 million--the NTT amount--was credited to the Trust Funds, but unlike September, none of this amount was invested in CIs because of the debt limit (see table II.4). Treasury again met required benefit payments from its available cash, and this was followed by redemption of available CIs (the $8,875 million remaining from September) and bonds. On October 9, 10, 15, 19, 20, 29, and 31, Treasury redeemed $4,558 million of 10-3/8-percent bonds maturing in 1989 to 1991. Also redeemed, on October 10 and 31, were $212 million of 10-3/4-percent bonds maturing in 1990.

During October, total redemptions of Trust Fund securities totaled $16,510 million. This amount, however, was $3,907 million less than the total CIs that would have been available for redemption had Treasury been able to follow its normal NTT investment procedures in September and October. (See table II.3.)

Because Treasury did not invest any of the NTT during October, the uninvested portion of the Trust Funds' assets grew significantly. At the end of October, the uninvested NTT portion of the Trust Funds was $15,131 million. The invested

portion of the Trust Funds had decreased to $23,087 million. (See tables II.1 and II.4.)

TREASURY ACCELERATED TRUST FUND REDEMPTIONS IN NOVEMBER 1985

The latter part of October saw the Treasury General Fund cash position continuing to worsen. It was expected that sufficient cash would not be available on November 1 to meet the government's obligations for that day, including $6,899 million required to meet social security payments by electronic fund transfer.

Treasury projected that it needed to borrow $13 billion on November 1 to meet its obligations and restore an adequate cash balance. After informing the Congress on October 22, Treasury proceeded on November 1 to disinvest securities of several trust funds, including the Social Security Trust Funds, to create sufficient borrowing authority below the debt ceiling. Accordingly, it redeemed $9,613 million of the Social Security Trust Funds' long-term securities on November 1. This was followed by additional redemptions of $4,181 million on November 4, $715 million on November 8, and $266 million on November 12. This disinvestment of the Trust Funds represented an acceleration of redemptions and was a departure from the normal pattern of redemptions to meet social security payments. The normal pattern of redemptions for November, in the absence of a debt ceiling crisis, is compared to Treasury's actual redemptions in table II.5.[3]

On November 1, the NTT amount of $13,088 million was credited to the Trust Funds but, as in October, remained totally uninvested until November 14, when the debt ceiling was temporarily raised. Thus, the uninvested portion of the Trust Funds again increased significantly, and as of November 13 the total uninvested portion of the NTT was $28,219 million. The invested portion of the Trust Funds was $9,098 million. (See table II.1.)

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[3]It should be noted that, for the November redemptions, Treasury departed from its normal redemption procedures for long-term bonds. Normally, Treasury redeems the earliest maturity date first and then within that maturity date, redeems the lowest interest rate first. In November, Treasury redeemed securities with the lowest interest rate first, regardless of maturity date. This was done to minimize the impact (i.e., potential interest loss) to the Trust Funds.

To cover the regular social security benefit payments in November, Treasury redeemed $13,742 million of long-term bonds maturing in 1991 through 2000 and carrying interest rates ranging from 8-3/4 to 10-3/4 percent. None of the Trust Funds' highest interest-bearing, long-term securities, at 13-3/4 percent and totaling $5,208 million, were redeemed during November or at any earlier time during the 1985 debt ceiling crisis. Also, absent the debt ceiling crisis, none of the other long-term bonds would have had to be redeemed in November if Treasury had been able to follow its normal NTT investment procedures in September, October, and November (see table II.3).

Tables II.6 and II.7 provide additional data on Trust Fund long-term bond redemptions between July and November 1985.

TREASURY DISINVESTED TRUST FUNDS DURING PREVIOUS DEBT LIMIT CRISES

The practices in which the Treasury engaged in September and October 1985 are not without precedent. Actions that the Treasury took in 1983 and 1984 are discussed in The Budget of the U.S. Government for Fiscal Year 1986, Special Analysis E. It is stated that lack of borrowing authority prevented Treasury from fully investing NTT amounts on the first of the month in November 1983 and in May, June, and July 1984. In addition, our analysis of Treasury's actions during the September-October 1984 debt ceiling crisis shows that the NTT was not fully invested on the first business days of either month.

In September 1984, the NTT amount credited to the Trust Funds was $13,575 million, $5,658 million of which was invested on the first business day, September 4. On October 1, none of the NTT amount of $11,561 million was invested.

During the September 6-October 12 period, Treasury redeemed 13-3/4-percent long-term bonds with maturity dates ranging from 1988 through 1990. Also redeemed were 10-3/4-percent bonds with maturity dates of 1986 through 1991. Also on August 31, 1984, 13-3/4-percent bonds were redeemed to finance social security payments by electronic funds transfer made on that date.[4] This took place on August 31 because the normal payment date of

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[4]The redemption of the Trust Funds' 13-3/4-percent securities followed the Treasury's normal procedure of redeeming the earliest available maturity first.

September 1 fell on a holiday (Labor Day), and there were insufficient CIs available to cover the required redemption. Thus, during the period August 31 through October 12, 1984, $9,854 million in long-term bonds held by the Trust Funds were redeemed. Specific information on these bond redemptions is given in table II.8.

POSSIBLE INTEREST LOSSES TO THE TRUST FUNDS

We did not attempt, as a part of this review, to determine the extent of possible interest losses to the Trust Funds. Based on the information available, it appears that no interest losses should result from Treasury's noninvestment of the NTT during September through November 1985. However, losses may result from the earlier than normal redemption of the Trust Funds' long-term securities during this period. Depending on changes in interest rates, long-term bond redemptions during September through November (and in earlier years) may result in losses or gains to the Trust Funds compared to a hypothetical situation where debt limit considerations are absent.

Our office has recently initiated a government-wide review of trust fund financial management activities, the results of which should provide a basis for assessing possible interest gains or losses to the Trust Funds.

SUMMARY

In reviewing Treasury's actions during the current debt ceiling crisis, we found that NTT amounts were not fully invested at the beginning of September, October, and November 1985. Instead, Treasury redeemed the Trust Funds' short- and long-term securities to meet social security payments. Our analysis shows that, if adequate borrowing authority under the statutory debt limit had been available during September through November 13, it would not have been necessary to redeem any of the Trust Funds' long-term securities. We also found that the noninvestment of NTT amounts in September and October was not unprecedented--similar actions were taken in 1983 and 1984. The actions of November 1985, however, appear to have no precedent.

APPENDIX II

Table II.1: Status of the Social Security Trust Funds
Fiscal Year through November 15, 1981

(Dollars in Thousands)

Description of transactions	July 1/	August 1/	September 1/	October 1/	November 15/
Cash	$ [illegible]	$ 1,616,747	$ 1,238,714	$ 2,239,581	$ 251,819	$ 0
Investments	[illegible]	113,801	278,451	407,868	66,737	18,756
Total	[illegible]	1,730,548	1,517,165	2,647,449	318,556	18,756
Assets:						
Cash	$1,616,747	$ 1,238,714	$ 2,239,581	$ 251,819	$ 0	$ 1,526,141
Investments	113,801	278,451	407,868	66,737	18,756	1,648,686
Total	$1,730,548	$ 1,517,165	$ 2,647,449	$ 318,556	$ 18,756	$ 3,174,827
Total investments	$1,730,548	$ 1,517,165	$ 2,647,449	$ 318,556	$ 18,756	$ 3,174,827
Accumulated amounts	0	213,383	870,302	1,588,893	18,737,923	25,410,501
Total assets	$1,730,548	$ 1,730,548	$ 3,517,751	$ 1,907,449	$ 18,756,679	$ 28,585,328

1/ Trust balance immediately following payment of July 1 SMI.

2/ Trust balance immediately following payment of regularly scheduled monthly SMI benefits.

3/ July and August amounts were the receipts in transit at the end of those months.
September-November amounts reflected those anticipated transmitted for transfers.

4/ Data were not available.

Table II.2: Social Security Trust Funds--Comparison of NTT Amounts Credited and Invested on the NTT Dates in Selected Months

(dollars in thousands)

NTT date[a]	NTT amount credited	NTT amount invested on NTT date
9-4-84	$13,575,000	$ 5,658,000
10-1-84	11,561,000	0
11-1-84	12,037,000	12,037,000
7-1-85	13,785,000	13,785,000
8-1-85	13,968,000	13,968,000
9-3-85	15,128,000	981,000
10-1-85	12,783,000	0
11-1-85	13,088,000	0

[a]First business day of the month.

Table II.3: Analysis of Potential Trust Fund Certificates of Indebtedness That Would Have Been Issued and Redeemed During September to November 1985 Without a Debt Ceiling Problem

(dollars in thousands)

Actual CIs at beginning of September 1985:	$ 2,759,466
NTT for September	15,128,000
Actual CI investments of other receipts in September	2,669,352
Total potential CIs to meet all redemptions in September	20,556,818
Total actual redemptions of securities in September	(16,109,865)
Potential CI balance at end of September 1985:	4,446,953
NTT for October	12,783,000
Actual CI investments of other receipts in October	3,186,775
Total potential CIs to meet all redemptions in October	20,416,728
Total actual redemptions of securities in October	(16,510,107)
Potential CI balance at end of October 1985:	3,906,621
NTT for November	13,088,000
Actual CI investments of other receipts in early November	785,653
Total potential CIs to meet all redemptions in early November	17,780,274
Total actual redemptions of securities in early November	(14,690,413)
Potential CI balance as of November 13, 1985:	$ 3,089,861

Table II.4: Summary of Uninvested Normalized Tax Transfers as of November 13, 1985[a]

(dollars in thousands)

Month	Trust fund	Normalized tax transfers	Uninvested portion	Cumulativ uninveste amounts
September 1985	OASI	$13,803,000	$ 2,142,546	
	DI	1,325,000	205,475	
		15,128,000	2,348,021	$ 2,348,021
October 1985	OASI	11,662,000	11,662,000	
	DI	1,121,000	1,121,000	
		12,783,000	12,783,000	15,131,021
November 1985	OASI	11,940,000	11,940,000	
	DI	1,148,000	1,148,000	
		13,088,000	13,088,000	28,219,021
Totals	OASI	37,405,000	25,744,546	
	DI	3,594,000	2,474,475	
		$40,999,000	$28,219,021	

[a]Before enactment of the emergency legislation temporarily increasing the statutory public debt limit.

Table II.5: Securities Redemptions on November 1st to Meet Regular Social Security Benefit Payments

(Dollars in Millions)

Description	Business dates							
	Nov. 1	Nov. 4	Nov. 5	Nov. 6	Nov. 7	Nov. 8	Nov. 12	Total
Actual redemptions	$4,912.3	$4,197.3	$0	$0	$0	$ 114.1	$266.1	$14,774.8
Planned redemptions without a debt ceiling crisis	5,989.0	0	0	0	4,816.0	5,210.0	0	14,925.0
Differences (actual as compared to planned)	$-1,076.7	$4,197.3	$0	$0	$-4,816.0	$-5,095.9	$266.1	$ -150.2

APPENDIX II

Table II.A: OASI and DI Trust Funds--
Summary of Bond Redemptions, July-November 1985

(Dollars in thousands)

	4-5/8%	4-5/8%	10-5/8%	10-3/8%	11-5/8%	Totals
Beginning balances, July 1, 1985	$ 196,156	$ 366,286	$21,615,774	$ 9,405,880	$ 5,208,116	$ 36,882,212
Redemptions:						
July	$	$	$ (638,217)	$ 0	$ 0	$ (638,217)
August			(1,808,345)	0	0	(1,808,345)
September			(6,901,028)	0	0	(6,901,028)
October	0		(4,557,576)	(212,348)	0	(4,769,924)
November	(196,156)	(366,286)	(6,741,334)	(7,796,058)	0	(15,742,110)
Total redemptions	(196,156)	(366,286)	(22,646,500)	(8,008,406)	0	(27,859,624)
Ending balances	$ 0	$ 0	$ 969,274	$ 1,397,474	$ 5,208,116	$ 9,022,864

Balances before transacting business on July 1.

Balances before enactment of legislation temporarily increasing the statutory public debt limit on November 14.

APPENDIX II

APPENDIX II

Table II.T: OASI and DI Trust Funds—
Asset Redemptions, July-November 1985

(Dollars in thousands)

Date redeemed	Maturity date	9-3/4%	9-3/4%	10-3/8%	10-3/4%	13-3/4%
OASI						
July	1	6/30/90		$ 39,944		
	5	6/30/90		4,445		
	8	6/30/88		165,451		
	31	6/30/85		134,201		
August	2	6/30/86		1,926,774		
September	3	6/30/87		1,451,250		
	5	6/30/89		1,435,737		
	9	6/30/88		636,564		
	9	6/30/84		1,860,100		
	30	6/30/84		67,144		
October	4	6/30/89		124,950		
	9	6/30/90		669,024		
	10	6/30/90		1,429,950		
	11	6/30/91		1,342,500		
	15	6/30/91		45		
	15	6/30/91		526,628		
	29	6/30/91		5		
	31	6/30/91		14,641		
	31	6/30/91		48,100		
	31	6/30/11		29,326		
November	1	6/30/91		67,052		
	1	6/30/92		565,186		
	1	6/30/93		565,186		
	1	6/30/94		565,186		
	1	6/30/95		565,186		
	1	6/30/96		565,186		
	1	6/30/97		565,186		
	1	6/30/98		565,186		
	1	6/30/99		565,186		
	1	6/30/00		2,057,101		
	1	6/30/92			$1,022,231	
	1	6/30/93			801,552	
	4	6/30/95			5,710	
	4	6/30/93			216,969	
	4	6/30/94			1,022,231	
	4	6/30/95			1,022,231	
	4	6/30/96			822,015	
	8	6/30/90			200,218	
	8	6/30/97			420,770	
	12	6/30/97			266,109	
Total OASI			$ 0	$ 0	$18,729,441	$5,798,034	$ 0

APPENDIX II

APPENDIX II

Table II.7 (continued)

Date redeemed		Maturity date	8-1/4%	9-3/4%	10-1/8%	10-3/4%	11-3/4%
1/							
July	2	6/30/86			$ 16,355		
	11	6/30/86			26,556		
	17	6/30/86			145,915		
	31	6/30/86			19,360		
August	2	6/30/86			181,571		
September	3	6/30/87			589,340		
	3	6/30/88			174,701		
	4	6/30/89			764,758		
	9	6/30/89			80,654		
	14	6/30/84			5		
October	4	6/30/84			508,402		
	4	6/30/85			74,108		
	10	6/30/90			98,035		
	10	6/30/91				$ 195,517	
	20	6/30/91			74,381		
	31	6/30/92				16,851	
	31	6/30/91			10,319		
November	1	6/30/93	$ 47,414				
	1	6/30/93		$ 142,557			
	1	6/30/94		142,336			
	1	6/30/94	339,277				
	1	6/30/95		199,042			
	1	6/30/95		551,571			
	4	6/30/91			15,101		
	4	6/30/92			47,400		
	8	6/30/92			94,257		
	9	6/30/93			28,904		
Total (1)			386,691	766,286	1,960,759	212,368	0
Total (All and (1)			$386,691	$766,286	$20,640,200	$9,010,382	$ 0

APPENDIX II

Table II.6: OASI and DI Trust Funds--
Bond Redemptions During 1984
(August 31 - October 12)

Dollars in thousands

Date redeemed		Maturity date	10-5/8%	13-5/8%	Total redemptions
OASI:					
August	31	8/15/05		$1,474,217	
	31	8/15/06		1,441,915	
	31	8/15/08		648,153	
September	4	8/15/08		63,540	
	24	8/15/06		558,670	
October	4	8/15/06		36,466	
	10	8/15/07		371,541	
	11	8/15/08		679,445	
	11	8/15/04	$ 194,454		
	11	8/15/05	824,346		
	11	8/15/06	1,022,251		
	11	8/15/07		404,684	
	11	8/15/08	628,619		
	11	8/15/09	145,974		
	12	8/15/06		277,429	
	12	8/15/07	21,841		
Total OASI			2,595,645	5,918,589	$8,517,236
DI:					
August	31	8/15/05		184,454	
	31	8/15/06		(67,411)	
	31	8/15/07	171,045		
	31	8/15/08	100,363		
October	5	8/15/07	163,252		
	9	8/15/04	15,459		
	10	8/15/05	287,956		
	11	8/15/06	98,441		
	11	8/15/07	60,004		
	11	8/15/08	212,495		
Total DI			965,415	352,865	1,336,778
Total OASI and DI			$3,561,060	$6,271,454	$9,854,014

Chairman LAFALCE. Yes; I would request that you do that, and I would ask that you distinguish as to whether or not you can use them for the purposes that Mr. Niehenke suggests they can be used for, and whether they can be used for the purposes for which Mr. Niehenke suggests that they cannot be, and Mr. Snyder suggests that may well be used.

Mr. NIEHENKE. I have a copy of a memo we sent to Chairman Jones of the Social Security Subcommittee yesterday in response to certain questions he asked, and if you have not had an opportunity to review that, I would cite one paragraph in there, in a section headed Authority to Redeem Trust Funds to Pay Benefits, and if you don't have this document, I will supply it.

It reads:

> Section 201(e) of the Social Security Act authorizes the Secretary to redeem trust fund investments. Sections 201 (f) and (h) of the Social Security Act provide that the proceeds of redemption are to become part of the trust funds and that the trust funds are to be used to pay benefits.

Chairman LAFALCE. The authority you just cited deals with redemption.

Mr. NIEHENKE. We would describe disinvestment as an accelerated redemption for this purpose. Again, it is this conflict that the Secretary has, to invest on one hand, to make assets available for payments on the other.

Chairman LAFALCE. The memo is narrative in form. It doesn't cite the actual language of the legislation. It is inconclusory. We will have to get the exact language and investigate that.

Mr. NIEHENKE. We would be happy to respond to any other questions you might have in that regard.

Chairman LAFALCE. Mr. Wortley?

Mr. WORTLEY. I appreciate your holding this hearing. This is very timely. We are all interested in this matter.

Mr. Havens, is there a precedent for the borrowing from the Federal Financing Bank? Has this ever been done before in a comparable sort of a situation?

Mr. HAVENS. No, it has not been, there has never been a comparable situation.

Mr. WORTLEY. This is a precedent?

Mr. HAVENS. It is a precedent in the sense that, to the best of my knowledge, it is the first time it has ever been used in such a way as to permit the Government to avoid the immediate impact of encountering the debt limit.

The Federal Financing Bank has borrowed from the public.

Mr. WORTLEY. Only once?

Mr. HAVENS. Correct.

Mr. WORTLEY. That was in the very early stages, and it paid a higher interest rate and decided after that point, better to borrow from the Treasury.

Is it your understanding, as it is the Assistant Secretary's, that it would take legislative action to repay the trust fund for the lost interest?

Mr. HAVENS. We have not researched the legal authorities, but my impression would be yes, that it would take special legislation. I can think of no other convenient, reasonably available means of doing so.

Mr. WORTLEY. Mr. Secretary, is it your intention to request the Congress to repay the lost interest?

Mr. NIEHENKE. We would not oppose such an action, Mr. Wortley.

Mr. WORTLEY. You would not oppose it?

Mr. NIEHENKE. No.

Mr. WORTLEY. Would you request it?

Mr. NIEHENKE. I understand legislation is already submitted for that purpose, or is about to be, and we would be happy to cooperate with that.

Mr. WORTLEY. Let's assume that we use the FFB in this creative type of financing. When the Government would be forced to sell its gold reserves, how soon would you expect that?

Mr. NIEHENKE. Assuming we use the Federal Financing Bank borrowing authority and the disinvestment of the trust funds, it is our view that we have a negative cash balance on November 15, and at that time, we would be faced with a default.

Mr. WORTLEY. Is that the only other alternative that you would have?

Mr. NIEHENKE. The Secretary, in a letter to the joint conferees, has indicated that another suggestion has been made that we should sell the gold, and he has concluded that that would not be appropriate, given the effect that that would have on the confidence in our financial system worldwide.

Mr. WORTLEY. What do you do?

Mr. NIEHENKE. We hope and pray for action on the debt limit.

Mr. WORTLEY. You are looking for the Congress to take some action, in other words?

Mr. NIEHENKE. We have been for some time, sir.

Mr. WORTLEY. Maybe I should ask Mr. Snyder this, from the public standpoint, or from the private standpoint, I should say, do you see any serious problems in this creative type of financing that we are currently engaged in?

Mr. SNYDER. There are perceptual problems that are being created. This committee's concern about the use of the Federal Financing Bank, it seems to me, is not inappropriate, given the legislative history of the Federal Financing Bank, but——

Chairman LAFALCE. That is something that has not been addressed and should be. Clearly, at the time the Federal Financing Bank was created, the Congress considered the possibility that its creation could be perverted, and, therefore, quite explicitly said in its conference report that it should not be used.

It would not be legal to be used for the purposes that it is being used for today—circumventing the debt limit.

I wonder, gentlemen, if the clear expression of congressional intent was taken into consideration? Mr. Snyder, who was present at the beginning, cited that congressional intent in his prepared statement.

Have I fairly summarized your statement on the congressional intent?

Mr. SNYDER. That is correct, Mr. Chairman.

Chairman LAFALCE. How do we square that expression with what would be illegal with what the Federal Financing Bank's actions are illegal? Congressional intent doesn't matter?

Mr. HAVENS. No, sir, not at all. We are not saying that. What we are saying is that the clear language on the face of the statute made it quite clear that this particular transaction, taken in its parts, was a legal transaction.

The clarity of the statutory language is such that we did not feel it necessary to resort to report language, if you will, to help interpret that language.

It was quite clear.

Mr. NIEHENKE. I think you are referring to an exchange between then Under Secretary for Monetary Affairs, Paul Volcker, and a Member whose name I don't remember, Congressman Burke—Congressman Burke did at that time question whether the Federal Financing Bank borrowing authority would be used for general debt purposes.

Under Secretary Volcker responded that it was not our intent to do so, and offered to work with the Congress in drafting legislation that would have the effect of not permitting that to occur. The final legislation did not have such a proviso in it.

Chairman LAFALCE. Mr. Snyder's comments dealt not with testimony given during congressional hearings, but a conference report on the bill itself.

Mr. SNYDER. That is correct, Mr. Chairman. The question of using the Federal Financing Bank to circumvent the debt limit was raised on the floor, I believe, in the House particularly, and the language in the conference report was intended to address that particular concern, but let me hasten to say that apart from this circumvention of the debt limit, which I applaud because of the terribly adverse consequences, if action had not been taken——

Chairman LAFALCE. We are in the unusual position of both deploring and applauding at one and the same time, are we not?

Mr. SNYDER. That is perfectly correct, Mr. Chairman. My old economics professor said it was a wonderful thing that the human mind could hold so many contradictory opinions at the same time, a wise man.

To address the question of costs involved here, there is no identifiable cost of using the Federal Financing Bank in the way in which it has been used, and subject to enactment of supplementary legislation which would make the trust funds whole, there is also no real cost involved in disinvestment of the trust funds. I would take issue with the view that Mr. Niehenke expressed regarding the propriety of disinvesting the trust funds in the first few days of the year, or of the month, in order to make benefit payments.

If one can accelerate a few days, then one can accelerate for more than a few days, and if the situation is such that ultimately the United States is going to default on its debt, it is going to default on its payments to its employees.

It is going to default on its payments to its contractors, and so forth. There are no assurances under those circumstances that the beneficiaries of the trust fund are going to receive anything, and for that reason, the higher duty of the Secretary of the Treasury in the interest of the beneficiaries of the trust fund, as well as in the general public interest, is to do the things that are necessary, and if he can find justification for accelerated disinvestment by a few days, he can find justification for——

Chairman LAFALCE. The necessity often results in tremendous legal creativity.

Mr. SNYDER. That is a wise statement, Mr. Chairman.

Chairman LAFALCE. I have a question that will be unpleasant to you, Mr. Snyder, on the basis of your testimony. Is there really a need for a Federal Financing Bank? Isn't this simply a legal fiction?

The Federal Financing Bank is subject to the general supervision and the direction of the Secretary. Its Board of Directors consists of the Secretary of Treasury, deputy general counsel, and the Fiscal Assistant Secretary of the Treasury. That being the case, shouldn't we just say that the Treasury Department shall have the following authority, and avoid the necessity of creating a separate entity, giving perhaps the Treasury Secretary the authority to borrow $15 billion above and beyond the debt ceiling limitation imposed by the Congress?

That is the practical effect of the Federal Financing Bank. The reason I ask this question is buttressed by the fact that the FFB hitherto had not borrowed independently, but always done its borrowing through Treasury.

I should not say always, but for the first few times.

Mr. SNYDER. Legal fictions are sometimes useful, and in this particular circumstance, I think that the Federal Financing Bank indeed is a useful fiction.

The reason I say that lies in history. As you will recall, prior to the establishment of the Federal Financing Bank, the Federal Government's agencies which made direct loans which appeared on the budget as budget outlays, were under considerable pressure, let me say both on the executive side and also on the congressional side, to market those loans, in which case the sale would be treated as a negative outlay, an ingenious concept, which would offset the effect of the original expenditure.

The reason for the pressure was that, as the Government direct lending programs were expanding and expanding at a relatively rapid rate, that was putting very strong upward trend into the total budget figure. I can recall the occasion when we hit $100 billion in total Federal outlays and that seemed to be a very critical point.

It wasn't too many years ago, so there was this political pressure to market these loans that had been made directly by an agency.

They did not market very well. You have heard comments to the fact that the one Federal Financing Bank issue which was sold in the market did not trade nearly as well as Treasury issues, even though it was the same basic direct obligation of the United States.

Well, these agency loans which carry guarantees which were very good guarantees in most cases, also did not market very well.

Now, many of those loans included substantial subsidies to the borrowers, and they were made at below-market interest rates. When you count up the cost to the Government and to the taxpayer of financing these in a relatively inefficient way, you were really doubling up on the costs of providing this credit to people in programs which the Congress and the President approved.

So, a good deal of the rationale for the Federal Financing Bank was simply to provide an efficient financing mechanism. Now,

there was a lot of debate at the time, and there has been debate since as to whether the Federal Financing Bank should come back on budget, which would mean to show those direct loans as outlays with no offset later when they were sold to the Federal Financing Bank.

I can't argue that that should not be done, but as a taxpayer, and sometimes student of Government, I am concerned that again, we would get back in the situation in which we were financing Government programs in a very inefficient and costly fashion.

Now, you don't need the fiction of the Federal Financing Bank necessarily to accomplish the things that the Federal Financing Bank has done, but you have got the fiction in place now, and I can't tell you how many employees the Financing Bank has apart from its distinguished Board of Directors, it is a handful.

It is probably as few people as you can possibly use to simply count the punch cards that come in and tell you how much Farmers Home Administration has financed in direct loans, and so on and so forth.

It is quite an efficient operation. If it were in the Treasury Department directly, it would take just as many people, so as a fiction, I am not particularly in favor of fictions, it has not been a hurtful fiction. The whole process of the Federal Financing Bank procedure, I think, has been a considerable benefit to the United States.

Chairman LAFALCE. Let me ask one last question.

I think the Congress is being cast as the villain in this entire episode—at least the House of Representatives—and it seems to me that that is blatantly unfair.

Let me ask you, what have the historical precedents been? The President of the United States, at the beginning of the Republic, and the Congress of the United States from the time there was a Congress, has frequently increased debt ceilings.

Do you know how many times there have been increases in the debt ceiling limitations?

Mr. NIEHENKE. I have no idea, Mr. Chairman.

Chairman LAFALCE. Maybe counsel could assist you?

Mr. SNYDER. As many as four times in 1 year.

Mr. NIEHENKE. It is at least once a year, and in the last several years, it has been a couple times a year, so we have engaged in this at least once a year.

Chairman LAFALCE. Different economists would disagree, different politicians would disagree but have we ever before attempted to attach such substantive legislation to an increase in the debt ceiling to your knowledge?

Mr. NIEHENKE. The debt limit bill has been a vehicle over time for many legislative initiatives. It is a compelling piece of legislation that at some point must be passed. It probably is true over time that there have been rather significant legislative initiatives attached to the debt limit.

Chairman LAFALCE. Can you think of any offhand?

Mr. NIEHENKE. I can research it.

Chairman LAFALCE. The fundamental question is not the debt ceiling, and it is not a willingness or reluctance on the part of the Congress to lift the debt ceiling, pursuant to the request of Presi-

dent Ronald Reagan, but it is a reluctance to go along with Gramm-Rudman which would fundamentally alter the constitutional relationships that have been established between the executive and legislative branches of Government, and I would say flagrantly violate the constitutional relationships that have been created by our founding fathers.

That is above and beyond the constitutional violations that we are being asked to do under the pressure of this debt ceiling limitation to resort to such extraordinary methods of financing governmental activities, and we have the question of its economic wisdom.

I don't see how anyone in his right mind could view it as economically wise. What was the opinion of the Treasury Department with respect to Gramm-Rudman prior to the administration position with respect to it?

Mr. NIEHENKE. I don't think we gave an official opinion with regard to Gramm-Rudman.

Chairman LAFALCE. What were the unofficial opinions within your office, Mr. Niehenke, prior to the administration position with respect to it?

Mr. NIEHENKE. I think prior to the disclosure of the position, I think there was a sense that it was the only vehicle on the horizon that seemed to begin to address, however it did, but seemed to begin to address the problem of the budget deficit and, therefore, should probably be pursued in an attempt to bring some program to bear which will over time cause the budget deficit to decrease.

Chairman LAFALCE. I am advised, and I suspect you can't make this statement publicly, that virtually everyone at the Treasury Department then and now abhors the concept of Gramm-Rudman economically; and perhaps even the White House, itself, because of the position of Secretary Weinberger, has not only second thoughts but wishes somehow it would go away, although they also wish they could maintain the political mileage they are getting out of it for as long as they possibly can.

Mr. NIEHENKE. I can only respond, Secretary Baker yesterday made a comment to the effect he supports Gramm-Rudman and hopes that the Congress can work through their differences.

Chairman LAFALCE. I am sure that is what he is saying publicly. Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman.

I have similar worries as our chairman's. Let me phrase it in a little different way. We have had these debt ceiling crises and in the past we have always been told, "Look, that is it, the Government is out of money, we are going to turn off the lights."

This time the Federal financing mechanism was discovered, and it seems to have been timed to—not to ram Gramm-Rudman down our throats, but to allow us a decent interval in which to examine it and come up with a few tentative conclusions, but yet not enough time for us to be able to get the Secretary of Defense to testify before the Armed Services Committee, not enough time for the head of the Veterans' Administration to testify before the Veterans Committee. There almost seems to be a code of silence imposed.

Unless they can support it, they are told to shut up. That puts us in a bind because we have time to read the bill. Its implications are

many and varied, and the gun to our head, the finger on the trigger is held by the Treasury Department, and here today we have conflicting testimony between you and Mr. Snyder over the extent to which you can accelerate redemption.

It is a technical question, as you can tell by the attendance in the room today. Even though it is of monumental importance to the Nation, there are very few people interested apparently in technicalities. It seems to me if you were sufficiently flexible to give us a brand new mechanism or previously unused mechanism of Federal financing bank authority to give us a month of breathing room, I don't see why you couldn't be equally flexible in perhaps taking into account Mr. Snyder's views in giving us a little more time so that we could hear testimony from the administration officials as to what exactly it would do to our Defense Department, our Veterans Department or any other number of other departments.

The finger on the trigger is your finger, and the flexibility that has been demonstrated this last month has been quite wonderful; we appreciate it. We might appreciate more additional flexibility. Are you willing to tell us today the options you have outlined to us are firm and fixed and that at no point in the future will the Treasury discover for its own convenience that, oh, well, there is really an additional week or month we didn't tell you about or, as Mr. Snyder would claim, an additional 18 months?

Mr. NIEHENKE. I can just respond, that these initiatives have been suggested by the Congress essentially and not by the administration. It is in our pursuit of the research of these initiatives, with regard to the disinvestment of the trust funds from a legal analysis point of view, we came to the conclusion, yes, in fact, they are legal; from a policy point of view, they may not be desirable, but when confronted with the prospect of default, they are clearly options available to the Secretary.

I might also say these extensions have been in some small way frustrating to the administration. The Treasury Department has been criticized within the administration for being able to do this. We are not totally without criticism within the administration.

Mr. COOPER. Mr. Baker's sense of timing is renown, and it seems to me if it had been rammed quickly down our throat, a lot of people would have objected on principles, because we haven't had time to read it. Now we have had time to read it, we still don't know what it means necessarily.

Mr. NIEHENKE. With regard to the last part of your question, Secretary Baker sent a letter to the conferees indicating what our options are at this point. He pointed to the trust fund disinvestment as probable in the event there is no action by tomorrow. He has indicated that is about as far as he is willing to go.

He has had suggested to him gold sales, which he has rejected, and, therefore, my representation to you is to the next day, if there is one, which is November 15.

Mr. COOPER. If I can ask one final question, why did you not come up with the FFB alternative in your previous debt ceiling crises? Why was it suddenly discovered now? Did you not have good lawyers back then?

Mr. NIEHENKE. I think the Secretary has a lot of things he can do legally. It is a question of what you want to accomplish. I think the Secretary is willing to bridge on a short-term basis a timeframe when it appears default is imminent and action is not going to occur.

There are clearly other things the Secretary could do, such as selling gold, that could buy a great deal of time. I think we had an estimate that if we sold the gold reserves of this country, we could go something like 3.5 months without further debt limit action. There are those vehicles available.

The Secretary is unwilling to consider those vehicles which are of a long-term nature and are purely evasive of the debt limit process. These suggestions have been made to us by the Congress. As I indicated, we have researched them and they are legal and only confronted when default——

Mr. COOPER. Does the Secretary object to giving Congress sufficient time to hear testimony from Secretary Weinberger and VA Administrator Walters? Is that a policy decision he is not willing to make?

Mr. NIEHENKE. I can't speak for the Secretary in that regard in that specific question, as to whether he is willing to let people testify, I just have had no conversations with him to that effect.

Mr. COOPER. To me, that is the situation we are facing. Tonight is the deadline, and despite protests, these people have not been heard of. And the Secretary's willingness to find other creative ways of reducing the deficit have ended. It seems to be a very flexible situation, what you choose to do legally and not choose to do.

To me, it is appropriate for the public to know where the finger is, whose finger is on the trigger.

Thank you, Mr. Chairman.

Chairman LAFALCE. Thank you.

We have been joined by Mr. Levin and Ms. Kaptur. I think Mr. Levin came in first. I will call upon him first.

Mr. LEVIN. Sorry I am late and missed the testimony. Both Congresswoman Kaptur and I were on the floor talking about financial issues, and one of the issues that was discussed during the 1-minute speeches related to the trust fund, and maybe I am going over ground already covered, so I will say a quick hello to Mr. Snyder from Michigan. I think that the Secretary testified, if I heard you correctly, that the action by the Treasury as to the Social Security Trust Fund was at the request of Congress?

Mr. NIEHENKE. A suggestion was made in a joint conference meeting, I guess 2 weeks ago. I was testifying as to what the timeframe was when we run out of money. The question raised by two of the joint conferees as to whether it was possible to do one of two things, either to sell trust fund assets outright, to hock the trust fund assets, in order to borrow money and to make beneficiary payments in early November, which was the point of concern at that point. We went back and researched those points.

Mr. LEVIN. So you said you had to look at them legally.

Mr. NIEHENKE. Yes.

Mr. LEVIN. In response to questions from two Members of Congress, not the Congress——

Chairman LAFALCE. Let's not say the administration was forced into something by two Members of Congress and then say Congress.

Mr. LEVIN. Yesterday before the subcommittee chaired by Jim Jones, as I understand it, the testimony was that such disinvestment had already occurred.

Mr. NIEHENKE. I think we discussed that point earlier with Congresswoman Oakar, and my comment at that time was there has not been a previous disinvestment of trust funds.

Mr. LEVIN. What was done earlier?

Mr. NIEHENKE. I think the discussion had to do with how the trust funds are managed in terms of how their assets are redeemed in the course of a month in order to meet payments. The redemption process we go through in the normal operations of the trust fund is very different from the accelerated disinvestment we discussed for early November.

Mr. LEVIN. So no special action was taken earlier this year in view of the debt?

Mr. NIEHENKE. No. Our conduct with regard to the trust funds has been consistent.

Mr. LEVIN. All right. I want to take that testimony and compare it with—did you testify before Mr. Jones yesterday?

Mr. NIEHENKE. Yes.

Mr. LEVIN. Because that is surely not his impression.

Mr. NIEHENKE. I think we had a definitional problem yesterday at the Budget Committee. There were alternate uses of terms like "uninvestment, disinvestment, redemption," and I think it was a fairly confusing atmosphere. I can't say that I made it more constructive. It got very convoluted.

I think the narrow question was with regard to the trust funds in October, whether disinvestment had occurred over and above what would normally be the case in the process of managing that trust fund, and there was an illusion that disinvestment had occurred. Our statement is that disinvestment did not occur, that the normal redemption occurred, and disinvestment, as we use that term, and by that term I mean the accelerated redemption of trust fund assets, is the transaction that we are talking about in early November.

Mr. LEVIN. So you are saying what you said yesterday was that last month or the month before, I am not sure of the time line, nothing different was done than had occurred in the 6 or 9 months previous to that. I just want in simple English a point blank answer. Forget about disinvestment, underinvestment, reinvestment, or whatever you want to—whatever terms you want to use. There is absolutely nothing done differently than had occurred the previous 8 or 9 months?

Mr. NIEHENKE. Of course, we have acted differently because we have had no debt capacity in which to make the older investments that should occur in those trust funds and the ordinary investment that should occur in the normalized tax transfer, so we have been frustrated since September 30 in making those investments. I can't say we have done nothing differently in terms of managing the funds or investing those assets. Clearly, because we didn't have that capacity, we couldn't make trust fund investments.

However, with regard to redemption of securities of those trust funds during that period, we have acted consistently among all the trust funds, and we have not accelerated any redemption, thereby disinvesting the trust funds for other purposes.

Mr. LEVIN. I can understand why they were confused yesterday.

Mr. NIEHENKE. I am sorry, it is not—it is a difficult conversation——

Mr. LEVIN. I think I understand you. I will try once more. You are saying there were certain things you could not do because of the debt ceiling.

Mr. NIEHENKE. That is right. We couldn't invest.

Mr. LEVIN. There are certain things you could not do. My question is, again, whether there is anything you did differently because of it?

Mr. NIEHENKE. We couldn't invest the assets of the trust funds, we couldn't operate the normalized tax transfer as it was designed to operate in 1983.

Mr. LEVIN. Is there anything you did do differently because of the debt ceiling, because we were running out of money?

Mr. NIEHENKE. Just the normalized tax transfer, which vehicle was designed to operate in a unique way, and that could not be executed as it should have been.

Mr. LEVIN. I will tell you, the chairman, who is a very distinguished and informed Member of Congress, surely doesn't understand it that way.

Mr. NIEHENKE. I think it is a confusing issue, and I would be happy to spend more time with him on it.

Mr. LEVIN. I think you should.

Thank you, Mr. Chairman.

Chairman LAFALCE. Ms. Kaptur.

Ms. KAPTUR. Thank you. I have read through part of your testimony but got involved in listening to you, so you will forgive me if I ask you to go over ground already covered.

There have been several proposals before Congress to remove the Social Security Trust Fund from the regular budget. I realize that when you are trained as an accountant, you don't mind blending moneys that come into the Federal Government.

However, there is a difference sometimes in people's views as to how retirement funds should be handled, whether they are pay-as-you-go funds or funds that are fully funded. I wanted to ask you, if the Social Security Trust Fund had been a budget item in the regular Federal budget, would that have changed anything you did over the last month? Would it have prevented you from——

Mr. NIEHENKE. Not to my knowledge; no.

Ms. KAPTUR. Not to your knowledge, all right.

Now, you made reference to 1983 and the Social Security Act that was passed at that time. Since I have been in Congress, we have had several votes on increasing the debt ceiling. I generally vote "no" on those.

I am interested in knowing, in spite of what was done to Social Security in 1983, was your behavior during the last month any different than at any point in the last 3 years during which we had a similar situation confronting us with regard to the debt ceiling? This has happened several times, we have come right up against

the wall, and then Congress has made a determination to lift that ceiling.

From what I heard you say here during the last month and based on the 1983 changes in Social Security, you did do something different than at previous times when we have come up against the debt ceiling. Am I hearing you correctly or incorrectly?

Mr. NIEHENKE. I just wanted to check, because of your question, on the last 3 years. We acted the same, if you will accept that description, last year, in October of 1984.

Ms. KAPTUR. We faced that then.

Mr. NIEHENKE. When we were simply confronted with the debt ceiling circumstance, our behavior is fairly consistent with what we did at that time. I can't say perfectly consistent, without getting into the minutia I don't have available to me. We are acting similarly to the way we treated this in October of 1984.

Ms. KAPTUR. You said you followed your normal redetermination procedures. Even if you get into some of the minutia for me, talk about what your behavior had been in 1984 and 1985, as we confronted coming up against the debt ceiling.

Mr. NIEHENKE. The key effect is we cannot invest.

Ms. KAPTUR. You mean you cannot invest the revenues——

Mr. NIEHENKE. The assets of the funds.

Ms. KAPTUR. And you generally invest those in Treasury securities, do you not?

Mr. NIEHENKE. That is correct.

Ms. KAPTUR. You cannot invest in that. That was true in 1984, and it is true in 1985, so that didn't change.

Mr. NIEHENKE. There are two different types of funds at work here. Let me describe the simple one, and then I will go to Social Security.

In the case of the normal trust fund circumstance, the trust fund gets revenues in over the course of a month. Those revenues are invested routinely and then when payments are made and claims are made on the fund those assets are disinvested, let me use the term "redeemed," and that completes the transaction.

In the case of Social Security, there is the normalized tax transfer. The way the normalized tax transfer is different from the other funds in this regard, the 1983 act provided a transfer will be made on the first of the month to that fund, that that transfer would represent the revenues that were coming into that fund during that month. Therefore, there would be an investment made in advance of the revenues as they came into the fund.

If you will, the fund is overinvested or preinvested at the beginning of the month. As claims are made on the fund through recipient payments, et cetera, that fund is redeemed accordingly by whatever amount, and this takes roughly a 4 or 5-day period between when the transfer is initially made and payments come in against that particular fund. That normalized tax transfer which should occur at the first of the month, and should occur and should be invested, could not be invested because we did not have debt capacity to meet that. That is consistent with 1984 where in a similar circumstance we could not invest the normalized tax transfer. As a result of that, we have an uninvested portion of the fund.

Ms. KAPTUR. Is that when Mr. Jones refers to a loss of $300 million in interest to the fund? Is that because you couldn't invest it?

Mr. NIEHENKE. Let me proceed, and I will address that for you. As a result, going forward, because we have no debt capacity, there is a growing portion in the fund which is uninvested. We simply cannot invest it because we don't have the debt capacity. Therefore, as the payments normally come in and claims are made against the fund, we proceed with a redemption procedure and redeem securities during the course of the month to meet those claims.

Now, what I think Chairman Jones was saying was that normally we have the normalized tax transfers to invest and, therefore, redeem. When you don't have the normalized tax transer invested and, therefore, available for redemption, you redeem other securities in the funds. That is a procedure which is consistent with the way we run other trust funds.

Chairman Jones has the perception, and maybe correctly so—we have to find out what the analysis will tell us—I think Chairman Jones has concern that we are redeeming assets in the fund at higher rates than currently available and, therefore, over time the fund is going to be disadvantaged as a result of that.

Ms. KAPTUR. I see. He used the figure, $14 billion has been redeemed.

Mr. NIEHENKE. That is the size of the normalized tax transfer in October. So his point, if I am correct, and you can ratify this with him, is that he believes due to that redemption process that went on because the normalized transfer investments were not available, the fund is going to lose interest over time.

He asked the Social Security actuary yesterday if in fact the fund would lose money. I understand the actuary responded to that committee, and I don't know if you have the benefit of that memorandum, but the actuary did two things: The actuary took a look at what the reinvestment prospects are going to be when we get the debt limit and we can get the assets and what some of the assumptions are.

First using the administration's forecast for investments of different maturity—actually I think he used the 4-year average maturity rate for this—he reinvested and analyzed what the effect of that reinvestment would be on that portion of the fund that was uninvested during this period. Using the administration's economic report review of 9⅞ percent, we concluded there would be a long-term loss in the fund of some $815 million, or roughly something like $86 million per year.

I think Chairman Jones used, in our exchange yesterday, a loss of some $300 million a year. I think I responded it was going to be $10 million, so we do differ——

Chairman LAFALCE. Per year or per month?

Mr. NIEHENKE. $86 million per year or $815 million over the life of the investments that he analyzed.

Alternatively, the actuary used the trustees' projection of rates, which is an exercise he goes through at the staff level, and then is taken up to the trustees for ratification. Upon doing the analysis of the trustees' expectation, the investment rate in this case, compared to the 9⅞, was 10⅞ percent.

In analyzing that over time, he concluded the fund would have a long-term gain of $421 million as a result of this redemption process, or roughly $43 million per year. The point—I am not trying to refute Chairman Jones' concern over the loss to the funds—the point is, though, that we can't adequately predict whether there is a loss or gain in the funds because the assumptions can vary dramatically over a period of time.

Ms. KAPTUR. Do they go back to the issue of what is being redeemed? Which other securities are being redeemed?

Mr. NIEHENKE. The securities being redeemed in the trust fund with the failure of having the normalized tax transfer are whatever interest bearing securities happen to be in the fund. With regard to that——

Ms. KAPTUR. Wouldn't we be able to do a computer printout of that? Don't we know what is being redeemed?

Mr. NIEHENKE. I think we do know, and I think the actuary has taken that into consideration in making these projections. The point is, Congresswoman, you know, I don't want to get into an extreme debate over whether we are going to lose money or how much we are going to lose. I want to represent, yes, the securities have been redeemed in the fund, there is no doubt about that.

There is now an uninvested and invested portion of the fund. When debt limit capacity is available, we will reinvest those funds as judiciously as possible. At the time we will be able to make a determination as to whether there was a loss or gain in the fund. It can happen either way, it depends on where interest rates go and where we are next June 30. We can't accurately predict whether there is a gain or loss or what is the magnitude.

Ms. KAPTUR. Mr. Chairman, would you grace me with 1 more minute here? In the Social Security area, some people are charging, as they did on the floor this morning, that we have invaded Social Security. Is it the normal behavior of the Federal Financing Bank, because Social Security does have extra revenue in the trust fund, for the Government to go into that vehicle?

Mr. NIEHENKE. We are not picking on Social Security. As we said in letters sent up to the leadership, and I think Congresswoman Oakar asked me earlier, and I might address now, as to whether we had gone on the record, and I would reference in my September 10 testimony I did indicate and identify the numerous trust funds that were going to be disadvantaged and uninvested during this period.

This problem of debt capacity has struck all the trust funds equally, and there have been losses accruing in many different trust funds in the Government. This is something that we predicted in our testimony, it is something we cited in our letters to the leadership. Social Security is not being singled out, we are not treating it differently from the other funds with the exception that it has this vehicle built into it called the normalized tax transfer that happens to make that fund work differently from the others.

Ms. KAPTUR. Thank you, Mr. Chairman.

Chairman LAFALCE. Unless there are any further questions by any of the members of the subcommittee, the subcommittee thanks Mr. Snyder, Mr. Niehenke, and Mr. Havens, and we stand adjourned.

[Whereupon, at 11:25 a.m., the subcommittee was adjourned subject to the call of the Chair.]

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